Critics of Capitalism

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ERRATUM

The following sentence was omitted from the beginning of the final paragraph on p. 165 of vol. 10, no. 2 ("Introduction: Nationalism in Theory and Reality"):

According to this view, the relationship between liberal universalism and nationalist particularity, while contradictory in the world of logic, is foundational in the real world of liberal nationalism: enhancements of egalitarian sentiment that take place in that world serve inevitably to buttress the power of actual liberal states—states, that is, whose egalitarianism is constrained by national boundaries.

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David Ramsay Steele

BETWEEN IMMORALITY AND UNFEASIBILITY: THE MARKET SOCIALIST PREDICAMENT

ABSTRACT: *The recent proliferation of economically informed writings favoring market socialism exhibits dissonances in this evolving theoretical orientation. The ethical presuppositions of classical socialism have often been inherited by those who now embrace markets under socialism. But precisely because it accepts markets, market socialism may prove incompatible with these sentiments.*

There has recently been a remarkable proliferation of writing about "market socialism."[1] For the most part this literature has been produced by self-avowed "socialists" who earlier would not have added the qualification "market." These writers maintain that they have come to recognize the shortcomings of non-market socialism, while their passionate hostility to "capitalism" remains unassuaged. Some market socialists have not changed much in the kind of socialism they envision; it's just that the intellectual climate has changed so that they think it prudent to advertise more loudly the "market" dimension of their socialism. In other cases, the writers announce their conversion from classical or Soviet-style socialism to market socialism.

One explanation for this change of heart, or of verbal emphasis, is the abrupt demobilization of "the socialist camp"—Soviet Russia

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and its numerous colonies, both inside and outside the U.S.S.R. This regime was widely believed to practice state central planning, otherwise known as socialism. So the story goes: the end of the Soviet Union dealt a blow to the reputation of socialism. The remaining socialists need to distinguish their socialism sharply from the Soviet sort, while pursuing the struggle against capitalism. Hence the new emphasis on market socialism. Although this is undoubtedly the way in which many Western socialists experienced events, the whole episode looks different from a broader perspective.

The definitive end of Soviet-style socialism has had a serious impact upon the ruling ideas of our epoch, yet there are clear indications that Marxism was in serious trouble before the point was reached when the imminent toppling of the Soviet regime could be expected with confidence. The growing recognition that the Soviet Union and China would be compelled to embark, somehow, upon the transition to capitalism, became quite marked in the 1980s. Among others, Andrei Amalrik, Steven N.S. Cheung, Harold Demsetz, Bernard Levin, Paul Craig Roberts, and Alexander Shtromas had all indicated as much by the mid-1980s or earlier. And there were those, like Marshall Goldman, Robert Kaiser, and Peter Rutland, who did not (as far as I know) predict a quick transition to capitalism, but did write convincingly about the desperate straits in which the Soviet Union found itself. Even some impeccable progressives had become aware that classical socialism was on its deathbed (see, for example, Howe 1994). Beginning in the early 1970s, a number of leading Marxists went public, so to speak, with the "crisis of Marxism," both as a movement and as a theoretical system (see Callinicos 1982, ch. 1), though naturally they always explained that a return to the essence of Marxism as they had identified it would be enough to put the patient back on his feet. The appearance and the reception of such works as Miller 1989, Nove 1983, and Schweickart 1980 confirm that a substantial "marketward" movement in socialist opinion predated the Soviet collapse. Meanwhile, a growing number of non-socialist observers had come to view socialist Russia as the world's sick man, immersed in a senescence not unlike that of the Ottoman empire a century earlier. If there had been a statesman of genius, instead of a Gorbachev, at the helm of the Soviet empire, it could have been kept afloat for several decades, but it might be that the prestige of Marxism would then have plummetted even more rapidly than it did.

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A comparison of the trajectory of Marx's reputation with the trajectory of Freud's may be cautionary. Freud and the whole mythology of the unconscious were criticized quite tellingly from the inception of psychoanalysis. Again and again eloquent arguments were levelled against Freud that were never satisfactorily answered. Yet the general influence of Freud upon intellectuals and artists seems to have remained undiminished, except among empirically minded psychologists, until around the end of the 1980s, when attacks on Freud started being taken far more seriously than before.[2] Had there been a Freudist instead of a Marxist regime, and had this regime fallen at the same time as its real-world Marxist counterpart, we would doubtless be tempted to attribute the puncturing of Freudist credibility to that downfall alone, overlooking the autonomous movement of intellectual opinion.

The abrupt decline in socialism's intellectual appeal applied to all forms of socialism without exception, and to market socialism as much as any other. Soviet-style socialism, market socialism (whatever, precisely, that may mean), the planning of development usually favored by socialists as the best way to achieve economic growth in the poorer countries, workers' self-management, and the welfare state—all of these emerged from the 1980s with less credibility than they had entered that decade; it does not now look as if any of them will stage a comeback soon.

There is no need to repeat here what happened to Soviet socialism. In retrospect, however, the failure of market reforms of the Soviet economy may come to be seen as market socialism's last throw. Western socialist parties which had once promoted the incremental nationalization of industry turned decisively against it, as in France, Britain, and Greece. The notion that governments could design the path of development in poor countries was already being tacitly abandoned in the 1970s, when there began a wave of privatizations in both the Third and First worlds, often supported by nominally socialist parties who would earlier have fought them bitterly. Workers' self-management was an idea that might have been expected to flourish given the discrediting of other forms of socialism, but although it picked up some interest among erstwhile advocates of Soviet-style socialism, it made no headway politically.

The welfare state came increasingly under attack for generating excessive burdens and social pathologies, most especially in its model cases, Sweden, Norway, and New Zealand. The groundswell of dis-

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quiet anent the welfare state (to many people a form, if not the paradigm, of "socialism," but to Marxists a form of capitalism) is particularly striking, because the welfare state has yet to enter the mortal crisis so frequently predicted: underclass mayhem is but a tiny cloud on the horizon, and the actuarial collapse, as governments find themselves compelled to default upon entitlement payments, is not due for another 20 or 30 years (see, for example, Wolf 1996). If the critics of the world's welfare states are right, then the welfare state is now more attractive than it can ever be in the foreseeable future.

Markets and Socialism

The final attempts by socialists to rescue socialism in Russia took the form of greater accommodation with the market. As János Kornai has it, market socialism "is merely its predecessor, classical socialism, in the process of falling apart" (Kornai 1993, 47). Since we know from Marx that ideology is only the material world's distorted reflection in the human brain, we may extend Kornai's characterization to surmise that the new vogue for market socialism among Western academics is merely its predecessor, the leftist academics' faith in classical socialism, in the process of falling apart.

The original "socialism" was market socialism *avant la lettre,* or at least in that it did not insist upon the elimination of all market relations. In early usage, "socialism" generally did not aim at the eradication of the market, whereas "communism" generally did. Marx the communist opposed Proudhon the socialist because Proudhon advanced a scheme to make the market conform to standards of justice, instead of seeking to abolish the market. At the end of Marx's life, however, Engels adopted the practice of employing the term "socialism" to mean Marxian communism. The old socialism, which did not insist upon the abolition of the market or even of private property, rapidly dwindled among both self-identified socialist intellectuals and socialist parties. The form of socialism which has dominated the minds of intellectuals in the twentieth century is therefore a set of doctrines that came into being, and defined itself from its inception, as a rejection of what had earlier been called "socialism," what might today be called "market socialism." "Socialism" became, at its core, communist: production for sale would be replaced by production for use, and the market ("com-

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modity production") would be abolished. Yet simultaneously, Marxism incorporated elements of the market into its conception of socialism.[3] Doctrinally, this occurred by transforming Marx's first phase of communism, with its non-circulating labor-vouchers and complete absence of money, into a form of socialism in which money and wages would persist.

This doctrinal shift was favored by the Marxist habit of supposing that the development of modern society was inherently driving toward the abolition of the market. It was considered utopian to try and force the pace. Looking too far ahead could constitute a distraction from pressing practical tasks. More palpably, the rank and file memberships of the socialist-led mass working-class movements displayed no interest in abolishing the market. Capitalism, it was supposed, could be counted upon, in the fullness of time, to make these reformist-minded proletarians revolutionary in their praxis. In the meantime, the scientific revolutionist would not want to move too far ahead of the workers themselves.

The Marxists were misreading capitalism's laws of motion. Nothing in capitalism was tending toward the obsolescence of the market. While socialists endlessly debated how soon capitalism would reach its terminal crisis and how the socialization of production would be conducted, modern industry was becoming more objectively dependent upon the existence of a substantially free market. Marx's theory that "commodity production" (production for the market) had evolved into a fetter on the productive forces was exactly wrong. The reality, though few theorists could have explained why, was that the growth of the productive forces *required* the market's "anarchy of production." The tenacious dogma of a long-term tendency for competition to give rise to concentration and thereby to "monopoly" was at odds with reality (Steele 1992, 274–80). Neither was there any tendency for wage-workers as a class to be thrown into conflict with capitalists as a class (see ibid., 370–74).

The Bolsheviks seized power with the rationale that the bourgeois revolution had played itself out; socialism was "now gazing at us from all the windows of modern capitalism" (Lenin 1964, vol. 25, 363). Since it had become clear that the centralization of industry through competition was, at least, occurring with disappointing slowness, the new theory, extrapolating from German experience, was that central control of the banks plus wartime administrative controls—"state monopoly capitalism"—was the road to socialism.

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At first the Bolsheviks believed that they would be helped out by victorious revolutions in the West, but when this prospect receded, the Bolsheviks could see no reason why they could not begin moving to socialism alone. Their attempt to institute socialism had to be abandoned in 1921, but the rise of Stalin and the beginning of the first five-year plan signified the creation of a new and enigmatic system which would survive until the 1980s.

This system was already a kind of market socialism that used money both in personal consumption and in industrial allocation. At the same time it appeared, paradoxically, to be a comprehensive system of planning by material allocations.[4] The inefficiencies of this system were so bizarre that the Soviet Union was compelled to allow some freedom of discussion in the area of economic policy, with the result that wave after wave of talk about market-oriented reform rippled through the ruling circles from the 1960s on.[5]

The history of the Soviet bloc after the 1930s was, superficially, one of greater recognition of, and greater reliance on, the market. Although there were successive measures which eliminated various kinds of private or market economy that had constituted exceptions to the main form of industrial organization, that main form itself was increasingly firmly characterized as "commodity production." From time to time measures were even enacted to encourage enterprises to behave more like rivalrous competitors, although these measures failed to bring about that result. The system failed because the government could not find a way to make state industry behave like capitalist industry. Whether there is some way to do this—whether an economy dominated by "publicly owned" enterprises can ever match or even remotely approach the efficiency of an economy composed mainly of competitive private firms—is the issue on which the practical feasibility of market socialism turns.

What Is the New Market Socialism?

During the 1980s, Western socialist intellectuals who had inhabited a milieu in which some version of the Soviet system, modified by this or that reform, was at least a respected option, found the climate changed: anything close to the Soviet system came to be beyond serious consideration.

But if classical socialism, or any adaptation thereof, is not the

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kind of socialism we want, what is socialism? And if, as socialists for the first time in 80 years agree almost unanimously, an acceptable socialism relies upon the market as a matter of principle, precisely how is it different from capitalism? Over the generations numerous socialists have wrestled with these questions, in successive waves of disappointment with Marxist theory or Soviet reality, so there is a ready supply of veterans who have been there already. But the latest wave of formerly classical socialists to be confronted with such questions may be the last wave, suspects itself to be the last, and is not greatly concerned with the thoughts of the earlier waves. The new market socialists rarely quote Eduard Bernstein, Anthony Crosland, or Sidney Hook.

The definition of socialism which seems to be the consensus, at least for the time being, is: (1) a market economy; (2) with some kind of public or noncapitalist ownership of much of industry; and (3) with workers' self-management (producers' cooperatives) in many enterprises. (1) is something socialism has in common with capitalism; its significance is that the new socialists renounce the goal of replacing the market with society-wide planning. (2) is the most controversial and the most vulnerable, because we have plenty of experience of state-run economies that endeavored to foster market competition among government enterprises, such as Hungary and Yugoslavia in the 1980s, and the results, while an improvement on classical socialism, were still markedly short of Western capitalism. There is now among socialists quite a lively awareness of the problem of the "soft budget constraint,"[6] for example, and this inclines them to believe that anything less than the autonomy of completely independent firms could be a serious problem for efficiency, while they are also uncomfortably aware that any such autonomy sadly renders the "public" character of the enterprises dubious. (3) refers to the internal organization of enterprises rather than the relations between enterprises as they constitute the whole economy.

Inevitably, then, the ambiguity, the equivocation, the search for new answers, is concentrated on (2), and especially on the problem of preserving (2) without abandoning (1). According to the older socialist wisdom, one of the great merits of socialism would be that all production units would conform to a common plan. They would not act at cross-purposes; they would not compete with each other; they would never have to close down and rudely move workers to other production units merely because financial results

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were negative. This view is now regarded by market socialists as naive, impracticable, and dangerous.

One alternative idea has been to give state-owned firms a great deal of competitive autonomy, but to allocate investment funds centrally. This is close to what was tried in Hungary for two decades. Some market socialists go even beyond this, however, and claim that capital markets can be incorporated within "socialism." David Belkin's survey of the course of recent socialist opinion concludes that "the use of markets in a planning framework shades into planning in a market framework, and social ownership shades into mixed ownership." He adds the question: "Does market socialism then simply shade into social democracy?" (Belkin 1994, 36).

Whereas John Roemer repudiates the notion that public ownership is a defining feature of socialism (Roemer 1993), Marc Fleurbaey describes his own proposal as neither capitalist nor market socialist, because there is no public ownership of production firms. Under Fleurbaey's scheme (which gives a good idea of the flavor of recent discussions of market socialism by its economically knowledgeable sympathizers), production enterprises would be owned by their workers. (Presumably there would be an inspectorate, to check up on firms and make sure they were practicing genuine self-management, penalizing workers who smuggled in departures from self-management. One can already hear the anonymous phone calls to this inspectorate from impeccably self-managed and unprofitable firms, setting the police onto their more successful competitors.) The stock and venture capital markets would be banned; the only type of external financing permitted would be for investors to deposit their savings with banks, which would then choose where to allocate credit. Fleurbaey argues that banks are better than securities markets at monitoring firms, which prompts the question why banks haven't already put the stock market out of business. To the objection that the restrictions imposed by his proposal "forbid mutually advantageous voluntary contracts of direct finance and wage labor, thus yielding a blatant inefficiency" (Fleurbaey 1993, 271), Fleurbaey responds that his proposed system achieves a public good effect, so there is a divergence between social and individual rationality; but it's not clear what public good he has in mind.

After listing some of the proposals for mitigating the efficiency problems associated with government ownership of industry, Thomas Weisskopf concedes that these cannot be expected to meet

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the "conventional efficiency criteria associated with a pure capitalist model," because the modified models restrict individuals' options for voluntary contracting. Weisskopf says that these inefficiencies are outweighed by "nonefficiency goals" and by "greater social rationality" (Weisskopf 1993, 120–21, 134). By greater social rationality, he means government action to correct for market imperfections, and by nonefficiency goals, he means greater equality, more democracy, and greater community. But it seems gratuitous to suppose that procedures which have been devised to rescue some workable form of "public ownership" after the classical form has been devastated by criticisms on efficiency grounds, will be especially well-suited to compensate for market imperfections (Putterman 1993, 165). And there is some obscurity about the ethical rationale for enforcing upon workers a tradeoff between real income and such values as equality, democracy, and community, different from the tradeoff those workers would arrive at by voluntary interaction. For the whole impetus of the new market socialism arises from the judgment that it is decidely *not* legitimate to bring about a *catastrophic* fall in real income in pursuit of socialist goals, as necessitated by classical socialism.

The Predicament of the Market Socialist

The driving force of market socialism is a barely diminished moral revulsion against capitalism allied with the recognition that attempts to institute workable socialism on classical lines now appear hopeless. The market socialists find themselves under opposing pressures from two sides: from the side of feasibility (and also simple humanity, since like all of us they want to avoid the suffering caused by grandiose experiments with inefficient institutions), they are impelled to admit increasingly more elements of capitalism; from the side of moral sentiment, they are impelled to root out as many of these elements as they can.

Critics of market socialism have repeatedly pointed out (Hayek 1948, 186; Steele 1992, 192) that as socialism incorporates more scope for the market, it disappoints traditional socialist aspirations, while not incorporating enough of the market to approach the efficiency of capitalism. In his unusually clear-headed defense of market socialism, Weisskopf puts it this way: "Modifications of market-

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socialist models designed to ameliorate their efficiency characteristics tend to bring those models into closer conformity with capitalism. In so doing, they tend to open up greater opportunities for the development of income inequalities and/or to reduce the scope of worker self-management" (Weisskopf 1993, 123–24).

The new market socialists' acceptance of the market makes it tricky to show that their socialism can offer much that is not equally available to the proponent of regulated capitalism. Market socialists often compare their own position with that of what they call "social democracy," a term they understand to mean regulated capitalism with state welfare provisions (Weisskopf 1994, 312–15; Belkin 1994, 36). The ideological geology here is ironic: the social democrats once travelled the same ground that the new market socialists now tread, but went a bit further. Social democracy as a movement used to be Marxist, it became by degrees market socialist, and now it is seen by the new market socialists as non-socialist by definition.

There is the question of whether an established market socialism could be a stable sociopolitical formation—whether it would be beset by crises of institutional instability, tending to push it either toward regulated capitalism or back toward classical socialism. But here I raise a different question: whether market socialism is stable *as an ideology,* whether it can endure to inspire future political movements. Let me appeal to a far-fetched analogy. There are Christian ministers who come to the conclusion that Jesus was never really born of a virgin, did not really change water into wine or wither the fig tree, and did not rise from the dead. As long as there are a good number of literalists who do believe all these stories, the freethinking ministers have some significance, but (it seems plausible) without the existence of a large body of believers who accept the Jesuine miracles literally, the freethinking ministers would not be able to maintain a substantial church for very long. They are always on a journey from Christian belief to its abandonment, even if most of them never quite reach that destination. Very roughly, we might say that this is so because the story of Jesus changing water into wine fits into a doctrine which has a power to convince, compel, and motivate. In Dawkinsian terms, it is a robust meme. The denial that this miracle occurred, however, draws most of its vigor as a meme from the fact that lots of people still believe the miracle did occur. The Marxist view of the world has also demonstrated a power to convince, compel, and motivate. But once

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certain crucial elements of this outlook have been abandoned, the result may be unstable, though its instability may be disguised as long as numerous individuals are making the transition from Marxism to the acceptance of capitalism.

Western academics who remain hostile to capitalism increasingly have recourse to technicalities of economic theory, to "externalities" and in particular to "public goods." We can understand this as a "socialism of the gaps," by analogy with the well-known "God of the Gaps," a derisory label for the intellectual phenomenon of theists basing their rationale for the theistic hypothesis on those things which science cannot yet explain satisfactorily. The contemporary academic socialist often proceeds by finding areas where the free market may not yield a theoretical optimum, and stakes out his case for socialism in these spots. Whatever we may think of the merits of such arguments, this kind of thinking emanates from a cast of mind alien to that of the traditional socialist, who holds (1) that markets are inherently irrational and wasteful; (2) that planning must always be superior to spontaneous human interaction; (3) that the existence of morally indefensible exploitation follows logically from the fact that individuals are permitted to receive interest on their savings; (4) that there is something demeaning and degrading in the fact that things are bought and sold; and (5) that inequalities of income and wealth are intrinsically bad. Of these propositions, the first two are factual ones, and now explicitly rejected by most socialists; the latter three are normative, and don't sit well with a wholehearted acceptance of the market.

A socialism of the gaps leads easily to regulated capitalism. Given the range of measures contemporary governments have implemented within a predominantly capitalist setting, it's not easy for market socialists to offer a plausible case that governments need to own enterprises in order to be able to correct some externality.

The Informational Role of Prices

Suddenly, it has become respectable to hold that Mises was right in his contention that centrally planned socialism cannot avoid immense inefficiencies because it lacks market prices for factors of production (Mises 1920). But the full purport of Mises's arguments against non-market socialism, and then against market socialism,[7] is

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often not grasped. Recent writers often point out, sometimes with evident puzzlement, that Nikolaas Pierson, Enrico Barone, Mises, and Hayek did not, in their arguments over the practical feasibility of market and nonmarket socialism, make much of the question of incentives. This was not, however, an oversight. It was a commonplace of discussions of socialism at the turn of the century that its feasibility turned upon questions of motivation. Socialists generally argued that people could be motivated to produce equally strongly by nonmonetary as by monetary motives, and that socialism would transform human nature, endowing people with different behavioral dispositions. Later, economists sympathetic to socialism (and even some quite unsympathetic) took the view that the strength of people's motives under different kinds of "material" or "moral" incentives was a matter on which economic theory *per se* could not pronounce.

Skeptics of the practical feasibility of socialism therefore had good reasons for seeking to establish that the calculational or informational objection to socialism stood by itself, independent of considerations of motivation. Thus, Pierson, Barone, and Mises developed a genuinely new argument. The old argument was that modern industry required the market because only pecuniary motives would be strong enough to get individuals to do what was required. The new argument was that only market prices could effectively transmit certain kinds of information about costs, so modern industry required the market (and therefore it could not dispense with pecuniary motives, since without these the market would not function). In my criticism of Joseph Carens's simulated-market socialism (Steele 1992, 207–228; see Carens 1981) I have taken Mises's argument a little further: there are certain important kinds of information that cannot be accurately captured at all unless the individual experiences prices as directly relevant to personal consumption. Therefore, even powerfully motivated individuals determined to behave exactly as they would in a private property market, but without actual private property rights, could not do so, because they could not know how they would behave in that imaginary situation.

Self-Management: Oversold or Underbought?

Socialists have often been ambivalent about self-management (or industrial democracy, as it has more aptly been called). If firms pro-

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duce for the market, then self-management does nothing to mitigate the typically capitalist phenomenon of competition. Independent, profit-seeking, self-managed firms will be just as inclined to subvert the great central plan as independent, profit-seeking, non-self-managed firms—perhaps more so, if the greater workplace solidarity that self-management proponents hope for does emerge. But once socialists abandon central planning and admit the need for competition, they often look more benignly on self-management.

Self-management in Yugoslavia has gone the way of Gosplan, and is just about as unlamented. Codetermination on the German pattern, which might be seen as a kind of halfway house to self-management, has never aroused much admiration among socialists outside Germany, presumably because it is too modest to possess any revolutionary glamor. Self-management proponents most often appeal to the example of the Mondragón cooperatives, but these are purely free-market entities which have achieved great things in non-belligerent coexistence with the capitalist environment. The Mondragón system could hardly have come about by any other route than that of being invented by individuals who had to justify every step according to financial results in a setting of voluntary transactions. A politically originated and imposed system would not have made the adjustments which now enable Mondragón to be recognized as successful. Yet we rarely encounter people who favor self-managed business enterprises on a purely voluntary basis without government involvement, or even those who favor legislation mandating that all enterprises be democratically managed, but then permit each enterprise to sink or swim according to ordinary business criteria.

Any consideration of self-management has to begin by recognizing that self-management is a legal and available option under capitalism; people are free to associate together in producers' co-ops, and they occasionally do. Thus, although the majority of arguments on the subject may give the impression that the topic under discussion is whether self-management is a good thing, we should bear in mind that the true topic is always distinct from that: it is whether self-management should be imposed on people who will not voluntarily opt for it.

I have elswhere presented a case against the imposition of self-management in industry (Steele 1992, 328–346). First, the legal system typical of capitalist societies permits the establishment of pro-

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ducers' cooperatives. Second, producers' co-ops show no sign of ousting more conventional management forms in open competition. They are chiefly popular with intellectuals of above-average incomes, especially academics, who see self-management as beneficial chiefly for non-academics. The self-management movement is very much of a piece with the intellectual's wish that the proletariat would be less boorish, for example by preferring folk-dance to football. The third stage in my argument is to look at various claims that self-management is somehow *unfairly* discriminated against within capitalism. I have argued that such allegations are without merit: in some cases the discrimination does not appear to exist; in other cases, it would be fair.[8]

The real-life failure of self-management to out-compete other managerial forms requires some explanation, and is difficult to reconcile with two assumptions often made by self-management proponents: that many workers would really love to have self-management where they work, and that self-management would lead to higher output. If workers like self-management, then they will be prepared to accept lower wages than they would accept in a non-self-managed enterprise. And if self-management made workers more productive, then it would yield a higher rate of return to investors, and funds would flow from non-self-managed to self-managed concerns. Notice that if *either* of these assumptions were true, and other relevant factors were neutral, the victory of self-management would be assured in a free market. Thus, observed reality suggests that workers either do not want self-management or want it so little that they are not prepared to pay (by accepting lower wages) what it costs (in reduced output).[9] If this is correct, then what justification could there be for imposing on workers a loss of welfare, by compelling them to accept self-management and lower living standards?[10]

Why Hate Capitalism?

Classical socialists hated capitalism in large part because it was unplanned; the haphazard, fetishistic character of allocations was perceived both as self-evidently inefficient, compared with conscious direction of the whole of industry, and as horribly demeaning to human dignity (Marx 1974, 76–84, 331–39; see Kornai 1992,

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110–11). This Marxian revulsion against the reign of the commodity cannot be consistently maintained by market socialists. The market socialist has to accept that the composition of society's total output, while it may be pruned and modified by judicious central intervention (just as the proponent of regulated capitalism would maintain), is essentially an unplanned precipitate of an anarchic process. The consistent market socialist must accept that profit seeking and money making are wholesome and worthy; but not all market socialists have thoroughly internalized this view.

Once the Marxian hostility to "anarchy of production" and "commodity fetishism" has been abandoned, we can detect two main grounds for continued moral outrage against capitalism: inequality and exploitation. If the indispensability of a thoroughgoing market economy is accepted, it becomes easy to see that most of the inequalities in income and wealth that would arise under *laisser faire* can be suppressed only at the cost of a loss of efficiency. That there is a tradeoff between efficiency and equality is now very widely accepted among proponents of regulated capitalism (see Okun 1975). And a passion for equality runs counter to the socialist notion of exploitation, which rests upon the theory that some people are being systematically deprived of the income equivalent of part of their productive contribution. If we imagine that equality could be imposed without affecting anyone's output, then the less productive people would *ipso facto* be exploiting the more productive people.

Consider David Schweickart, a former Marxist, now a market socialist, who still thinks interest immorally exploitative, or at least lacking in any solid moral rationale. If there is a market economy, then individuals will be able to accumulate savings. If individuals are permitted to invest (in the everyday sense of the word) their savings, they may be able to get an interest return. According to the Marxian theory of surplus value, whose crucial assumptions Schweickart and many market socialists still seem to uphold, any such return can only be exploitative, in some ethically culpable sense. In Marx, this is based on the notion that interest (or "profit") comes at the expense of labor. Only labor creates value, therefore interest is a deduction from the laborer's product.

Here we need to distinguish between two contentions: the claim that the capital equipment made possible by saving and investment makes no contribution to the value of the product, and the claim

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that, whether or not capital equipment makes any contribution to the product, the owner of that equipment should not be entitled to receive any return from its provision, because (for example) merely owning a machine is purely passive, whereas working with the aid of that machine is active (and only "active" pursuits should be entitled to be paid); or (to take a quite different example) because the owner of the machine came by it illegitimately (he inherited it from his grandfather, who stole it). Marx's theory rests crucially on a version of the first contention. He took the view that capital equipment, as it is used up, can do no more than pass on its own value to the product; all new creation of value, and hence all "profit," comes only from labor. Though Marx also endorsed the second contention (Marx 1974, 667–93), this is peripheral to his account of exploitation. It is, however, the second contention that most readily appeals to gut socialists who have not read Marx.

Distinct from these two contentions, yet interacting with them, there is the issue of how, purely as a factual matter of price theory, the interest return to owners of capital is determined. Leaving aside all ethical questions, can we best explain the determination of interest by unpaid labor, as in Marx, or is interest the price of a productive contribution, as most non-Marxist economists maintain? If the latter, can the pricing of this productive contribution best be explained by pure "time preference," by some interaction of time preference and investment opportunities, by the productivity of capital, by "waiting," or by the capitalist as a supplier of "time"? Partisans of these various non-Marxist theories may disagree over important matters of theory, but most accept a common core of assumptions: that saving makes possible such things as machines, that machines make an objective contribution to production, that the owner of a machine may therefore be expected to get the market price of that contribution, that the amount of the contribution and therefore the amount of the payment can be explained by the theory of marginal productivity, and that there is a price differential for goods appearing at different times: people will pay more for something the sooner they take delivery of it. Unfortunately, Schweickart goes through parts of some of these alternative theories piecemeal, without isolating and confronting their common core.

The main drift of Schweickart's argument seems to owe a lot to his use of the term "productive activity." If only "productive activity" is to be considered to make a contribution to production, and

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if only labor is productive activity, then only labor makes a contribution to production, and (if only a contribution accords entitlement) the laborer is entitled to the whole of output. Some such argument seems to underly Schweickart's reasoning. For instance, Schweickart asks: "Suppose a government suddenly nationalizes the means of production, then does nothing else but charge workers a use tax. We wouldn't say, would we, that the government is engaging in productive activity, or that the tax is a return for the government's productive contribution?" (Schweickart 1993, 11).

Notice how this reasoning depends upon a term, "productive activity," which would not normally be employed here by a defender of the productive contribution of capital. Thus Schweickart's line of reasoning fails to address squarely the intuitively obvious point that capital makes a contribution to production, even if that contribution is not "activity." If A makes a spade, and B uses the spade to dig a trench, we wouldn't say, would we, that A makes no contribution to digging the trench? Obviously and indisputably, A does. (Schweickart does not, of course, explicitly deny this fact; he fails to address it explicitly.) But even more fundamentally, *the spade* makes a contribution. If the spade had fallen out of the sky, and B had picked it up, it would be B's good fortune, but there would be no doubt that the spade did make a contribution, in the sense that output would be higher than without it. In this case the contribution can be identified rather simply: it is the increase in the ease and speed with which B can dig the trench. If we ignore the effects on B's hands and frame of mind, the spade's contribution is a certain increment of trench dug per hour—physically equivalent to having another laborer doing some of the digging. In many cases, this simple comparison cannot be made, because the capital enables labor to produce something that could not be produced at all without that specific type of capital. In such cases, however, we can say that the product made possible by the specific type of capital is valued more highly by consumers than other products, and we can capture the notion of that specific capital's contribution by the marginal productivity theory.

It is a separate question whether A ought to be recompensed for his spade's contribution, and if so, how much, but the fact that the spade makes a contribution, in the plain sense that its presence affords an increase in output over its absence, can hardly be contested. The distinctiveness of these two issues is underscored by

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H. G. Johnson in a remark quoted by Schweickart, who taxes Johnson with tending to "mislead normative thought" (Schweickart 1993, 12). But it is Schweickart who is doing the misleading here. There is nothing normative about the statement that capital goods make a contribution to output; it is a generalization from a lot of facts, such as the fact that a spade makes a contribution to digging a trench. Nor is there anything normative about the claim that this contribution can be characterized by the theory of marginal productivity, or the further claim that under competition, your income, whether wages for your labor or interest on your savings, is the value of your marginal product. Whether true or false—and they seem to be true—these are all value-free, purely factual claims.

If capital makes a contribution to production, the question arises of who should in justice get the income which corresponds to that production. The answer traditionally given by libertarians is that this income should go to the rightful owner of the capital, or more strictly, that it is not contrary to justice if it does go to that owner. The rightful owner is defined as the person who acquired it by legitimate means: broadly, by voluntary sale or gift, or by making it out of materials he acquired by legitimate means. In practice, this most often translates into savings out of earnings. On this view, given an appropriate legal system, most of society's current stock of capital is owned by people who have worked and saved to accumulate it, or, in the case of widows and children, have received it by bequest from those who worked and saved. Of course, serious criticisms might be made of this kind of normative approach or of its practical applications, but Schweickart is hindered in making them here because of his muddling of the issues. He seems reluctant to grant that the volume of output owes something to capital equipment. Alternatively, he perhaps thinks that there is no connection between the present existence of this equipment and past voluntary acts of saving.

Pursuant to Schweickart's argument, then, the government "nationalizes" the means of production, confiscating them from their former possessors (who may be the rightful owners), and now pockets what would have been the former possessors' interest payment. Does this really demonstrate either that the means of production make no contribution or that no payment for this contribution should go to the former possessors, in large part the people whose savings made those means of production possible? If so, then

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a parallel argument proves that labor makes no contribution, or that the rightful owner of labor (the laborer) should not, in justice, be paid. For the government could own slaves and provide these to entrepreneurs, charging the entrepreneurs a "use tax."

Schweickart also conflates interest and entrepreneurial profit. Entrepreneurial profit comes from outguessing the market; an entrepreneur who does this reaps a portion of the gains he has conferred on society by moving resources to a hitherto overlooked superior allocation. Entrepreneurial profit or loss is conceptually distinct from interest. Schweickart gives an example of an entrepreneur who innovates and then reaps a perpetual gain (Schweickart 1993, 14–15). He asks: does the innovation justify the perpetual gain? In Schweickart's example, it's not really clear how the capitalist's *innovation* is connected with the perpetual gain, but if we suppose that she made a big entrepreneurial gain initially, because her new plow was such an improvement over prior technology that she sold a lot of corn by undercutting the prices charged by other farmers, then this would give her a temporary entrepreneurial profit. Like all entrepreneurial profit, this would be ephemeral under competition, since other producers would copy the innovator, but it might in a particular instance help an entrepreneur to accumulate a sum which might then yield income perpetually. No one claims that this income after the initial period is proximately due to innovation. It is (*ex hypothesi*) interest on capital, not a reward for innovation. The perpetual gain (after the initial innovation) comes from the stock of capital. Provided the capitalist keeps on maintaining or replacing the capital, refraining from spending it on her current consumption, this capital makes a contribution to output. The capitalist receives the equivalent of that contribution to output, a contribution her investment of her savings has made possible. This strikes me as eminently fair, and Schweickart offers nothing against it.

Schweickart does offer an argument apparently designed to show that someone who invests her savings in building machines does nothing to increase production (Schweickart 1993, 18). This is a form of an old socialist misconception about the relation between real and financial capital (Steele 1992, 195–200). Schweickart's claim is that if we look at what happens when an entrepreneur borrows money from someone with accumulated savings to buy a machine, we find that either the machine, or the means to make it, existed already, so the money savings are unnecessary. What this overlooks is

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that financial savings correspond to real savings: the more people save, the more it is possible to produce "for tomorrow" instead of "for today." The fact that the machine exists or can readily be made and the fact that someone has accumulated money savings are not unconnected. If the saver had instead blown the money on throwing lavish parties, society's stock of real capital ("machines") would now be smaller. If people suddenly became hugely less inclined to save, say because they believed the world was certain to end at midnight on December 31st, A.D. 2000, we would witness spectacular "capital consumption." Much capital equipment would cease to be replaced or maintained. There would be less equipment available to invest in future production, just because people would spend more of their incomes on current consumption.

Schweickart further argues that while the machine in his example could be purchased by the government printing money, instead of being purchased out of a capitalist's savings, we wouldn't say that printing money was productive. But inflating the currency does not, as a general rule, add to the stock of real capital. (If it did, we would not be so quick to grant that it wasn't productive.) Those most distant from the government's spending on that machine face higher prices as a result of the addition of printed currency; the machine has been purchased at their expense, much as if they had been taxed to pay for it. By contrast, the capitalist's saving is a deduction from her own current consumption, not from someone else's income.

Schweickart also attacks the legitimacy of interest as a manifestation of time preference. He states: "The jacket I wear today is the same jacket I shall wear next week" (Schweickart 1993, 22). Does this mean that Schweickart would be willing to pay the same sum for a jacket to be delivered one year or 20 years from now as for a similar jacket to be delivered this afternoon? Schweickart goes on to argue that time preference cannot be the explanation for interest because, when a capitalist lends to an entrepreneur, it cannot be true that the entrepreneur has a higher time preference than the capitalist, since the entrepreneur is not borrowing in order to consume. But Schweickart is mistaken in supposing that the time-preference theory requires the entrepreneur to have a higher time preference than the capitalist. It is a fact that no one, not even Professor Schweickart, in general views a good to be acquired in the remote future as equally valuable as an otherwise similar good to be ac-

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quired in the near future. If, instead of receiving wages a week or two after they started work, workers were asked to wait until their products had been sold before they got their pay, they would have to be paid a higher amount.

Another leading exponent of market socialism, John Roemer, suggests that the touchstone of socialism is that "profits" be equally divided among the population (Roemer 1993, 89ff). Roemer agrees that it would not be feasible to have complete equality of incomes. Thus, his market socialism would permit unequal wages, but would eliminate the possibility for individuals to accumulate savings yielding an income, and the possibility of a person's being able to "make a killing" by combining factors in a way which no one else had managed to perceive but which turned out to be highly productive. My point here is not to try to guess what peculiar view of modern industry allows someone to acknowledge that labor incomes have to be unequal, while insisting that incomes from saving and entrepreneurship be distributed equally. (Imposing either kind of equality would seem to run the risk of a serious reduction in output.) What is relevant here is the continuity of moral outlook carried over from classical socialism: the fierce distaste for incomes earned by saving rather than by laboring.[11] This moral selectivity is all the more remarkable because in our economy nearly three quarters of the national income is payments for labor,[12] and of the remaining quarter, a very substantial portion at any one time has been saved fairly recently out of labor earnings. Differences in labor earnings, it would seem, have more weight in determining the actual pattern of income differences than do differences in wealth ownership. We might perhaps have expected to encounter some equalitarians, who, as a concession to practicality, would be prepared to permit unequal property incomes while insisting on equal wages for all and any occupations.[13] But we almost never do: the socialist conviction that present income from past saving is somehow morally tainted is very deeply rooted, though I know of no serious rationale for it.

There is a dissonance between the moral outlook that most commonly inspires people to be socialists and acceptance of a major role for the market. Because of this, the new market socialism is unlikely to endure as an ideological alternative in its present form. It is best seen as one route by which its proponents may gradually come to accept the optimality and the moral acceptability of some form of capitalism.

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NOTES

1. I am responding here especially to Bardhan and Roemer 1993, an excellent collection of consistently high-quality papers representing several points of view; Roosevelt and Belkin 1994, which contains some insightful contributions, and overall gives a vivid mosaic of the turmoil in recent socialist thinking; and Schweickart 1993, a fresh and forceful attempt to reformulate the case for socialism taking account of recent developments.
2. As perhaps the most striking indication of the way things are going, see Crews 1995.
3. In Kautsky's 1902 pamphlet on the Erfurt Program, he insists on the need for money and wages in the early stages of socialism, and recognizes that this will come as a shock to some of his readers (Kautsky 1902, 129). In later works, Kautsky continued to move toward greater acceptance of elements in the organization of socialism which earlier Marxists would have considered purely capitalist.
4. The notion that the Soviet economy was ever centrally planned was called into question by such writers as Michael Polanyi, Paul Craig Roberts, Hillel Ticktin, and Eugene Zaleski. See Steele 1992, 266–68.
5. In the early 1960s the Western press was abuzz with talk about "Libermanism," the proposed introduction of more reliance on profits in guiding the performance of Soviet state firms. Was the Soviet Union going capitalist? Soviet ideologues replied that profit and loss had played a key role in the management of Soviet enterprise since the 1920s. There was, they maintained, no incongruity between socialism and profits.
6. The problem of the "soft budget constraint" refers to an unintended but apparently inescapable consequence of any attempt to substitute vertical administrative commands for horizontal market relations in determining the total composition of output: the emergence of extensive vertical bargaining. In this context, such enterprise goals as profitability or cost reduction cannot stably be given the "hardness" they manifest under capitalism. The administration of "classical socialism" is unable to adopt a consistent stance of "sink or swim" with regard to the enterprises. See Kornai 1992, 140–44; Bardhan 1993.
7. Widespread use of the specific term "market socialism" (*Marktsozialismus*) arose at the beginning of the 1920s, with Eduard Heimann and Karl Polanyi. Mises responded to their proposals in Mises 1923; these arguments were incorporated into Mises 1936. His main criticisms were that the proposals were unclear on whether industrial organization would be syndicalist or truly socialist, and that the market socialists focused exclusively on enterprise managers, ignoring the allocational role of capital and money markets.
8. For example, it is not necessarily unfair when business enterprises do not get all the bank loans they want, and if banks discriminated against self-managed firms, this could be fair, if the banks believed that loans to self-managed firms were more risky. See Steele 1992, 338–42.

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9. My argument does not require that we can specify the reasons why self-management may be inefficient, and is independent of any such claims, or of their purported refutations. But there is, of course, no shortage of plausible suggestions. Some of the main reasons, according to economic theory, why self-managed firms will tend to be less efficient than more conventional firms are summarized in Arnold 1994, ch. 5.
10. In Steele 1992, 334–35, I go on to explain why it is intelligible that workers, in the great majority, don't buy self-management, and why, despite indefinitely rising real incomes, they may never buy it.
11. Pertinently enough, Arneson (1993, 289) raises the question of why the entire population, who receive these "profits" under some market socialist proposals, are not then culpable "exploiters." In a careful, extended analysis, Arnold 1994 shows that the organizational structures of market socialism would permit and encourage forms of exploitation normally precluded under capitalism.
12. U.S. Bureau of the Census 1994, 452. Table No. 692 shows that "Compensation of Employees" for 1993 was 73.38 percent of national income. Since morally charged socialist discussions often tacitly assume that "profits" typically go to "corporations," it's worth noting that the same table yields total pretax corporate profits at 9 percent, or just over 5 percent after tax. The point of bringing this up is not to belittle the ethical importance of corporate profits—if it's immoral to get a return on one's savings, then it's immoral to get a small return on one's savings—but to emphasize that the profits of corporations are not the biggest source of income inequalities.
13. Arneson remarks that market socialism "is liberally tolerant of inequalities of income stemming from the labor market but rigidly intolerant of inequalities of income stemming from differential ownership of capital by individuals" (Arneson 1993, 282). Arneson's paper acutely clarifies some of the different strands of moral thinking which combine uneasily in socialist discourse.

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David Schweickart

DR. PANGLOSS GOES TO MARKET

ABSTRACT: *David Ramsay Steele's* From Marx to Mises *argues correctly that the standard account of the economic calculation debate is a misrepresentation. Mises and Hayek were not bested by Lange and Taylor. However, it is not true, as Steele claims, that socialists have yet to face the Misesian challenge, nor that the debate over socialist calculation sheds much light on the recent collapse of communism. Steele's critiques of market socialism and worker self-management and his treatment of Marx are, moreover, deficient, as a consequence of his "Libertarian Panglossism."*

Tout est au mieux . . . dans ce meilleur des mondes possibles.

Here is a story that has become recently fashionable: Ludwig von Mises launched a major debate in the 1920s by arguing that economic rationality is impossible under socialism. The debate raged for more than a decade. When the dust settled, almost everyone agreed that Mises and his defenders (most prominently, Friedrich von Hayek) were wrong, and that his critics (Oscar Lange and Fred Taylor, in particular), were right. But now we see, in light of recent historical events, that it was the intellectual consensus that was wrong. Mises was right—socialism is impossible—and he was right for the right reasons.

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David Ramsay Steele, author of *From Marx to Mises: Post-Capitalist Society and the Challenge of Economic Calculation* (Open Court, 1992), claims to have seen through the false consensus sooner than most. "In the 1960s I was under the spell of Marx," he writes, but on encountering Mises's economic calculation argument, "I immediately recognized it as the most powerful objection that has been made to Marxian socialism." Now, "less in agreement with Mises's theory as a whole than I came to be in the 1970s, I still maintain that socialists have yet to face the challenge of economic calculation" (xvii–xviii). Steele also maintains that understanding the Mises argument will help intellectuals grasp what they have hitherto been unable to comprehend, namely the collapse of the Soviet Union. "To them what has happened still possesses a fairytale quality" (xvii).

So we have here two basic claims, (1) that socialists have yet to come to grips with Mises's argument, and (2) that this argument will clarify the events of 1989–91. What are we to make of these claims?

On the face of it, Steele's charge that socialists have yet to face the economic calculation challenge seems odd. Market socialism, with its Mises-like critique of central planning, has been the object of both theory and practice for several decades now. In the 1960s and 1970s various East European Communist countries began introducing market features into their otherwise centrally planned economies. When John Rawls wrote his monumental *Theory of Justice* (1971), he drew on the work of British economist (and later Nobel laureate) James Meade to argue that some form of market socialism—but not centrally planned socialism—might well satisfy his principles of justice. In 1979 China began introducing the market reforms that have had such impressive results.[1]

To be sure, the Left in the West was slower than real-world socialist reformers to embrace the concept of market socialism. When Alec Nove's *The Economics of Feasible Socialism* appeared in 1983, with its trenchant criticism of Soviet central planning and its insistence that the market must be used to make socialism efficient, it was the expression of a minority viewpoint among Western socialists. But a sea change occurred during the 1980s and early 1990s. A large outpouring of theoretical and empirical studies has transformed a minority view into a near consensus.[2]

But have socialists *really* come to grips with the full import of

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Mises's "calculation problem"? It is one thing to acknowledge that markets are necessary for economic efficiency; it is quite another thing to demonstrate that markets are compatible with *socialism*—a claim that Mises explicitly denied. Let us look more carefully at the Mises argument.

The Economic Calculation Debate

Steele's account follows closely that of Don Lavoie (1985). Both begin with the "standard version" of the debate: In 1920 Mises published a short article, republished two years later in a widely read volume, claiming that a rational socialist economy was theoretically impossible. If the state owns all the means of production, he argued, those enterprises producing machinery and other intermediate goods (producer goods as opposed to consumer goods) cannot be exchanged in a genuine, competitive market. But without a genuine market for producer goods, their true values cannot be ascertained, hence they cannot not be rationally allocated.

Defenders of socialism responded with the correct observation that if under socialism the prices for consumer goods are accurately set by the market (something Mises allowed), then, so long as the input requirements for each consumer good can be specified, the prices of these inputs can be determined by simply solving the appropriate set of simultaneous equations.

According to the standard version of the debate, Mises and his ardent supporter Hayek quickly retreated from the claim of theoretical impossibility. They argued instead, cogently enough, that although such a solution might be possible in theory, the computational difficulties render it unworkable in practice. Not only would it be extremely difficult to collect the necessary data so as to construct the equations, but to solve a system of equations that describe an entire economy would be far beyond the reach of existing computational technologies.

Oscar Lange then weighed in, according to the standard version, with a definitive rejoinder.[3] He demonstrated that if socialist managers follow two simple, practical rules in determining what combinations of inputs to use and whether to expand or contract production (utilizing the "accounting prices" set by the Central Planning Board),[4] and if planners then adjust these "accounting prices" in ac-

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cordance with supply and demand, the economy will tend toward an optimally efficient equilibrium—as efficient as would obtain in a perfectly competitive capitalist economy, and more efficient than would obtain in a capitalist economy with monopoly elements.

End of debate, or so it appeared. Virtually all economists who concerned themselves with such matters, among them such luminaries as Joseph Schumpeter and Abram Bergson, agreed that Lange had won. It could still be argued that the Soviet model was inefficient, since Soviet planners were not following the Lange rules, but it could not be maintained that socialism was *inherently* inefficient.

Lavoie and Steele dispute this rendition of the debate. They are right to do so. I am persuaded by their evidence that the standard account is a misreading of the actual debate, or, in any event, that the standard account is only *one* reading, and not the most fruitful one.

First of all, neither Mises nor Hayek were concerned to dispute the "theoretical" possibility of socialism, if by "theoretical" one means an abstract model of the sort so dear to the hearts of neoclassical economists. Both were concerned, always, with socialism in practice. Mises's initial, provocative article appeared shortly after the collapse of Lenin's War Communism. Mises held socialist theorists to be at least partly responsible for that disaster, since they had been utterly remiss in thinking through the "theoretical" issues that would cause socialists such *practical* difficulties.[5]

Secondly, it was the socialists, not Mises and Hayek, who were forced to retreat—and retreat repeatedly—during the course of the debate. Mises's 1920 article begins by arguing that there cannot be a rational economy without money. He pushes further, arguing that using labor values for prices won't do, either. Then he makes his most original claim: even if wages are paid, and supply and demand are allowed to set the prices for consumer goods, a socialist economy will still be irrational.

Intelligent socialists were compelled to grant Mises's first two points, the first with the proviso that the economy in question be one of scarcity, the second unconditionally—these concessions marking a retreat from earlier, widely espoused socialist positions. But they resisted his third argument. Here they invoked the mathematical solution. But as noted above, Mises and Hayek were quick to point out that the mathematical solution was utterly unworkable in practice.

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Then came Lange—but did he really win the debate? As Lavoie (1985, 166) points out, it is rarely mentioned in the standard accounts that Hayek (1940) responded directly to Lange's challenge, arguing, first of all, that Lange's "socialism" was no longer a centrally planned economy (yet another socialist concession), and in any event that his "simple rules" could not be effectively applied in a real-world economy. In the Lange model the Central Planning Board is no longer doing much planning, intent as it is on mimicking the free-market solution; but it is still trying to set prices, prices for *all* producer goods. This is a simple matter "in theory" but—given the number of goods, the qualitative differences among similar goods, the presence of specialized, singular goods, the continuously changing conditions of production—impossible in practice.

Mises and Market Socialism

Lavoie and Steele are right to say that economists were too quick to declare Lange the winner in this Great Debate. They are right too as to one of the reasons. Most economists were (and still are) under the seductive spell of the neoclassical paradigm, the mathematical formulations of which are so elegant. If we stay within that paradigm, Lange wins. Hayek's rejoinder can be ignored, since it appeals to real-world considerations that are difficult to model, and hence are of little interest to the high-prestige sector of the economics profession.

Lavoie and Steele neglect a second, more fundamental reason for Mises's dismissal, namely, the historical events that unfolded during and shortly after the debate, but I will defer for now a consideration of that reason. The question to ask first is this: How relevant is the economic calculation debate to the current theories and practices of market socialism?

Until now I have been treating Lavoie and Steele together, since the latter follows the former's exposition rather closely. On the question of market socialism, however, they diverge. Lavoie uses the term "market socialist" to refer to Lange and to the other participants on Lange's side of the debate. Steele does not, and he is right in not doing so. For Lange and company were *not* market socialists. The Lange model is an attempt to *simulate* the effects of a free mar-

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ket. It retains a Central Planning Board. It does not permit a competitive market for producer goods.

Steele maintains that the economic calculation debate has great relevance to contemporary models of market socialism, and indeed, he devotes considerable effort to criticizing market socialism as such. But the relevance of the economic calculation debate to market socialism is distinct from Steele's own critique of market socialism. Let us consider the first issue first. Is it true that socialists have yet to confront the Misesian challenge?

The stark fact of the matter is, neither the standard version of the debate nor the alternative reading presented above has anything to do with market socialism. As Steele himself acknowledges, both sides in this dispute accepted an identification of socialism with a lack of genuine markets for means of production. Mises made the lack of such markets a part of his definition of socialism (Steele 8, 107). Lange and company did not object, since this was the dominant conception of socialism at the time. Instead, Lange tried to show that market allocations of capital goods could be simulated. Mises and his defenders challenged the effectiveness of such simulation.

But it has long been recognized by theorists of market socialism that the distinction between markets for consumer goods and markets for producer goods, so central to the Mises-Lange controversy, takes one up a blind alley. Contemporary market socialists do not want to *simulate* capital-goods markets. They want real, competitive markets for both consumer goods *and* capital goods. Various technical considerations (the degree of market concentration in an industry or the presence of serious externalities, for example) may dictate the regulation of some of these markets, rendering them less than totally free—but whether the objects of production are consumer goods or producer goods does not determine whether they should be produced for markets. Certain sectors of the economy may be kept out of the market for political or ethical reasons (education or health care, for example), but no such reasons can be adduced to exclude producer goods as opposed to consumer goods per se.

If market socialists would allow competitive markets for both producer and consumer goods, then Mises's basic argument—that socialist planners, however well intentioned, cannot allocate producer goods effectively because they lack the concrete, specific,

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sometimes tacit knowledge available only to the producers themselves—does not apply. Market socialists *agree* with Mises's critique of central planning; they agree that lack of knowledge as well as inappropriate incentives constitute deep, largely insurmountable problems for central planning—which is precisely what makes them *market* socialists. Steele seems not to realize that contemporary market socialism is defined (and defines itself) by its opposition to central planning. On the central issue of the economic calculation debate, the possibility of a socialist society constructing a workable mechanism for simulating the effectiveness of a real market for producer goods, the Misesians and the market socialists are on the same side. To be blunt: contemporary market socialists have looked hard at the classic Mises-Hayek critique—and have acknowledged its validity. Mises and Hayek have won yet another round.

But have they won the game? What market socialists do not concede is that socialism is impossible. Market socialists continue to insist that it is possible, both theoretically and in practice, to abolish (most) private ownership of the means of production, and still have an efficient economy. They claim that a market socialist economy, properly constructed, would reduce many of the gross inefficiencies and irrationalities associated with *capitalism*, and at the same time promote many of the ethical values that have long been part of the theory, if not the practice, of socialism—most notably, equality and democracy.

Before examining Steele's critique of this proposition, let us take up his contention that the economic calculation debate helps us understand the dramatic events of 1989–91.

Mises and the Collapse of Communism

In assessing the relevance of the economic calculation debate to market socialism, I agreed with Lavoie and Steele that the weight and prestige of neoclassical theory inclined economists to favor Lange over Mises. But there was a second factor even more compelling, although unremarked by either Lavoie or Steele, that turned economists against the Mises position. In the middle of the controversy about the irrationality of socialism, it was capitalism that plunged into near chaos. The Great Depression threw tens of millions out of work. This "temporary aberration" persisted for a

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decade, coming to an end only with the massive, planned, deficit-financed mobilization of men and resources that constituted the economic underlay of World War Two. Moreover, at precisely the time when capitalism seemed prostrate, the Soviet Union, eschewing the market, was engaged in the most rapid process of industrialization the world had ever witnessed. This process continued apace after the war, allowing the Soviet Union not only to rebuild itself from the colossal destruction inflicted on it by the German invasion (and without the massive infusion of U.S. aid that went to Western Europe and Japan), but to achieve technological parity, even supremacy, in at least a few areas. The Russian atomic bomb came four years after ours. Its hydrogen bomb came only one year after ours. And it was the Russians, not the Americans, who launched the first successful space satellite. To have proclaimed, in the era of Sputnik, that "socialism is impossible" would have been incredible. Indeed, neither Mises nor Hayek persisted with the economic argument after the war. When Hayek (1944) declared socialism to be "the road to serfdom," he meant political servitude, not economic destitution.[6] In the 1950 preface and epilogue to his 1932 work, Mises (1951) inveighed against the welfare state and decried the Russian menace, but he was no longer calling socialism unworkable.

It could be argued, of course, that the calculation problem identified by Mises eventually caught up with the Russians and dragged them down. Today this view is widely held. It appears to be held by Steele. But a reader looking for *evidence* supporting this view will be disappointed. Steele laments the fact that "intellectuals who instruct students in the humanities and convey to successive generations the ruling ideas of this epoch . . . are at a loss to give any serious explanation of the Soviet collapse" (xvii), but the reader is no wiser about this matter after 375 pages of text. Steele takes it as an apparent fact that "tolerably high living standards for the masses require private property in the means of production, along with substantially free capital and money markets" (xvii), and he repeatedly alleges that interference with the market leads inevitably to impoverishment (207, 214), but no evidence is offered that it was the peculiarly Misesean informational defect in the Soviet system, i.e., the inability of planners to get the prices of producer goods right, that did it in. There are many other possible explanations: the strain put on the Soviet economy by the intensified arms race, the deliberate Western attempts to subvert the Gorbachev reforms (Gowen 1990),

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the inability of the Soviet system to innovate as rapidly as that of the West or to take advantage so quickly of new information technologies, the difficulties in motivating ordinary workers ("They pretend to pay us; we pretend to work"), the seductiveness of a consumer culture that the Soviet system was either unwilling or unable to duplicate.[7] Steele occasionally suggests that it was the Soviet practice of copying world market prices for their producer goods that enabled them to stave off the effects of the informational problem for so long (268), but he offers no evidence for this dubious claim.

Let me be clear. I do not think that the Soviet system was an optimally efficient system done in by nefarious external forces. I have been arguing for nearly two decades that the command-economy model upon which the Soviet economy was based is radically deficient (Schweickart 1980), *in part* for reasons adduced by Mises. But it is one thing to say a system is suboptimal. It is quite another to assume that the main reason for its lack of optimality is the information problem identified my Mises. It is yet a third thing to assume that the suboptimality due to the information problem was severe enough to cause the system to collapse. It is a fourth thing, still, to conclude that all forms of socialism are unworkable. Steele may believe all four of these claims, but he offers the reader no reason for going beyond the first.

Steele's Critique of Market Socialism

The economic calculation debate was, in essence, a debate about the feasibility of central planning. Its primary focus, as we have seen, was the question of getting prices right for producer goods. Toward the end of the debate, however, Hayek took note of a proposal by some "younger economists who have given thought to these problems [who are] prepared to go the whole hog and to restore competition completely, as least so far as in their view this is compatible with the State retaining the ownership of all the material means of production" (Hayek 1935, 218).[8] Here, for the first time, a Misesian participant in the debate addressed what we now take to be the essential form of market socialism. Hayek acknowledged that "this proposal really evades most of the objections to central planning as such." It does, however, raise problems "of an

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extremely interesting nature [which] in their pure form raise the question of the *rationale* of private property in its most general and fundamental aspect" (219, emphasis Hayek's). Precisely.

Curiously, Steele does not address Hayek's discussion of market socialism. He does, however, see Mises, also late in the debate, extending his basic argument in a manner applicable to real market socialism. It is not clear that Mises himself grasped the import of this extension. He continued to maintain that socialism by definition excludes genuine markets for means of production (Steele, 108–9). Still, the claim is important:

> It is above all necessary that capital should be withdrawn from particular lines of production, from particular undertakings and concerns, and should be applied in other lines of production, in other undertakings and concerns. This is not a matter for the managers . . . ; it is essentially a matter for the capitalists—the capitalists who buy and sell stocks and shares, who make loans and recover them, who make deposits in the banks and draw them out of the banks again, who speculate in all kinds of commodities. (Mises [1932], quoted by Steele, 108.)

Steele takes Mises to be arguing that since there are no *financial* markets under socialism, managers would not be able to allocate capital correctly—*even if* there were a market for producer goods. Whether or not Mises himself would have formulated his thesis in such a manner, this is a fair interpretation of his remark. Hayek's reservations about market socialism may likewise be formulated as a claim about the necessity for financial markets. Neither Mises nor Hayek elaborate this thesis in detail, so Steele proceeds to develop it on his own, as his contribution to the critique of market socialism.

The issue is important. Contemporary versions of market socialism allow for markets in both consumer and producer goods (thus rendering irrelevant most of the economic calculation debate), but most proposals substantially restrict or radically modify financial markets, since these are the institutions deemed most responsible for the inequalities and alleged irrationalities of capitalism.

What exactly do financial markets do? Might their functions be duplicated by other institutions having fewer negative consequences? These are crucial questions for market socialists. All contemporary models of market socialism grapple with them, but as yet there is no consensus as to the best answers.

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Unfortunately, Steele's treatment of these questions will be of little help to anyone seriously trying to come to grips with the underlying issues. In essence, the problems alluded to by Mises are of two types: the first is what has come to be known (following Kornai 1986) as the problem of the "soft-budget constraint"; the second is the problem of the "socialist entrepreneur." The first problem is that of shutting down unproductive enterprises. Since virtually all forms of socialism are committed to full employment, and since governments *can* keep unproductive enterprises afloat, how can public officials be motivated to let unproductive enterprises go bankrupt? The second problem is that of entrepreneurial initiative. If individuals are prohibited from risking their own capital and starting their own businesses in hopes of reaping a huge reward, how can we insure that innovations in products and production processes will be forthcoming at an optimal rate?

These are serious questions. Today, all serious proponents of market socialism wrestle with them. All serious models of market socialism propose institutional solutions. Unfortunately, Steele does not address *any* of these proposals.

In part he has the excuse of timing. Many of the most widely discussed contemporary proposals (see Roemer 1994, Schweickart 1993, Roemer and Bardhan 1993) appeared in print after Steele's own book. But still, such volumes as Vanek 1971, Schweickart 1980, and Nove 1983 were accessible to him. Indeed, they are listed in his bibliography. Leland Stauber and James Yunker, two other well-known proponents of market socialism, have been defending their models for decades. (See Staube 1987 and Yunker 1992 for recent elaborations.) It is hard for me to understand how one can offer a serious critique of market socialism and not address any of the specific proposals of its proponents.

Steele's procedure, instead, is simply to point to the functions performed under capitalism by specific institutions that market socialists propose to eliminate, then to declare that without these institutions there will be inefficiency. For example, he argues that since market socialism will not have stockbrokers, bond traders or other such speculators, it will necessarily be less productive than capitalism (195–200).[9] Now, as matter of fact, certain models of market socialism—Roemer 1994, for example—*do* have stockbrokers. (In Roemer's model the stocks are denominated in nonconvertible currency, so they can be traded for other stocks, but not

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cashed in; thus, an initially egalitarian distribution will not become inordinately unequal over time.) Other models rely on alternative mechanisms for generating investment funds. (In both Schweickart 1980 and Schweickart 1993 I propose generating the investment fund by taxing the capital assets of each enterprise.) Of course one may question the efficacy of such alternative proposals, but they cannot be refuted by simply pointing out that stockbrokers and bond traders perform a useful function under capitalism.

It is difficult to have much confidence that, had Steele turned his attention to analyzing concrete proposals, the result would have been perspicuous. He comes close to addressing a concrete proposal when he examines briefly "the frequent socialist proposal to arbitrarily determine a rate of savings for society as a whole." He concludes that such a determination "must *ipso facto* be inefficient, because individuals are no longer free to increase their personal savings. This reduces their individual utilities in much the same way as any restriction on their choice of consumer goods" (199).

Steele's formulation of the issue leaves something to be desired. I know of no socialist proposal that forbids private savings. What Steele probably has in mind is something like my own proposal, which has the central government set the tax on capital assets (my surrogate interest rate), so as to generate an investment fund of specific size. This tax is not *arbitrary*. In determining the rate, the government must take into account enterprise demand for investment grants—although the rate is not set automatically by market forces. Individuals are not *prohibited* from saving. Individuals are free to save whatever they want—but (in the strict version of my model) no interest is paid on these funds.[10]

Now, there is nothing easier for anyone who has learned the basic neoclassical moves to demonstrate Pareto nonoptimality here. One can imagine an investor who would like to borrow at a rate lower than the state banks are offering, and a private saver who would like to make a little money on his surplus and is willing to take the risk. If the payment of private interest were not forbidden, an exchange would take place. Some people would be made better off (the borrower and lender in this case), and no one worse off. Q.E.D. This is Steele's argument.

The huge flaw in such an argument is precisely the flaw Steele himself calls attention to in another context. Given two alternatives, "it would be an elementary blunder to cite some of the disad-

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vantages [of one] in the belief that this disposed of the procedure, [since] it has advantages which may conceivably outweigh its disadvantages" (239). It simply won't do to cite an instance of micro-inefficiency in some real or imagined version of market socialism to dispose of it. Yet time and again Steele ignores his own admirable advice. Unless one makes the double assumption that real-world capitalism is itself Pareto optimal and that Pareto optimality trumps all other values, such arguments are, if not wholly vacuous, at least radically incomplete.[11]

Steele on Marx

Steele's book is not only about Mises. The other name in the title is Marx. On the back cover Barry Smith calls Steele's book "probably the best, and certainly the most readable book on Marxist economics we shall ever have."

I must say that this is a breathtaking claim. One can only conclude that Professor Smith has read very little of Marx. He hasn't even read Steele very carefully, for Steele states that "I don't attempt to present here a 'balanced picture' of Marx's theories, but only an accurate picture of some elements of his thought intimately related to economic calculation" (xvi). I don't want to belabor the point, but Steele passes over quite a few of the basic concepts of Marxian economics: the nature of surplus value, the distinctions between labor and labor-power, between absolute and relative surplus value, between simple and extended reproduction, between developed and primitive accumulation. I do not fault Steele for these omissions. His book is not a treatise on Marxian economics. He doesn't claim that it is. But he might have been more judicious about the endorsements he chose to display on back of his book: false advertising.

Steele does examine a significant number of Marxian topics, not all of them related to the economic calculation problem. (He has a long discussion of historical materialism toward the end of the book, the rationale for which eludes me.) Steele is not sympathetic to Marx. He has warned the reader not to expect a "balanced picture." But he tries to be accurate and fair.

He doesn't always succeed at accuracy. He claims, for example, that according to Marx, "the capitalist pays the full cost of a ma-

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chine, but pays less than the full cost of labor" (55). But it is the centerpiece argument in *Capital* that profit is possible even though all input commodities, *including labor power*, are purchased at full value (Marx 1967, 146–76). Marx resolves this apparent paradox by distinguishing between labor and labor power, that is, between work and the ability to work. What a capitalist purchases is the latter, Marx argues, not the former, and since the latter is a commodity, its value is determined like the value of any other commodity, namely by what it takes to produce the commodity. What it takes to "produce" labor power are the wages that must be paid to maintain workers at their accustomed standard of living. What they themselves produce is quite independent of this wage bill. (Anyone who thinks that the labor/labor-power distinction is metaphysical and hence without practical consequence should consider the situation of computer programmers and software designers in California now forced to compete with their counterparts in Bangladesh.)

Steele's misrepresentation of Marx in this instance is egregious, but fortunately this case is not representative. One can argue with many of his interpretations of Marx, but for the most part these interpretations and the criticisms that follow from them, while not original, can be taken seriously.

Worker Self-Management

As a long-time proponent of a form of socialism that recognizes the right of the workers of an enterprise to control that enterprise democratically, I find myself disappointed by Steele's cavalier treatment of what is an important topic.

"Overwhelmingly, co-ops fail in competition with conventional firms," says Steele (349). He cites no evidence for this confident assertion. He says, "we do not know precisely why co-ops fail [but] we do not lack good models predicting failure for co-ops" (349). But neoclassical theorists have no trouble constructing models that predict the failure of *anything* departing from strict *laissez faire*. Finding corroborating evidence is another matter. Virtually every study done on this issue has concluded that worker-managed firms, matched against comparable capitalist firms, are at least as efficient.[12]

Steele admits that "the sociological literature is overwhelmingly

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favorable to self-management" (although he does not cite any of this literature). In fact, he finds almost everyone apart from hard-nosed economists predisposed to the idea. "The general failure of self-management occurs despite a powerful prejudice in self-management's favor, a prejudice that pervades the entire culture" (344).

What are we to make of such a remark? It does seem to be true that most workers, given the choice, would prefer to work in a democratically run firm. Samuel Bowles, David Gordon, and Thomas Weisskopf (1990) report that two-thirds of the respondents to a 1975 poll of Americans said that they would prefer to work in a worker-controlled company. Henry Norr (1987) cites a 1985 survey that found 85 percent of Polish workers wanting full self-management. But what workers want and what they get are, of course, two different things. Neither the capitalists who own the vast majority of enterprises in the United States, nor the bureaucrats who controlled the enterprises in Poland in 1985, nor the powerful forces that emerged in Eastern Europe after the collapse of communism there (see Gowen 1990 and 1995) had or have any intention of turning "their" enterprises over to the employees. Certainly none of the major political parties in the United States, nor any of the major newspapers, nor any of the major television networks have ever endorsed such an idea. I think it safe to say that the vast majority of working people here have never even heard of the idea of worker self-management. They have certainly not heard it discussed seriously.

I doubt that Steele would be moved by my objection. Workers are also consumers, I would expect him to reply, and so what they get *is* what they want. Steele, like most neoclassical and Austrian economists, sees a capitalist economy as controlled by consumers. Mises goes so far as to proclaim that consumers are the "true owners" of the means of production under capitalism (Mises 1951, quoted by Steele, 188). Steele himself thinks "consumers could, if they desired, abolish [the present order] and establish a different system" (336). It would seem to follow that I and like-minded consumers should simply stop going to work at our nondemocratic institutions, and stop buying the commodities produced by nondemocratic firms. We should spend our time instead persuading others to follow our example. Sooner or later, if we are patient and persistent enough, and if people really do want a democratic economy, the market will deliver us our preferred Utopia.

Now why didn't *I* think of that?

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Libertarian Panglossism

> Pangloss taught metaphysico-theologico-cosmolo-nigology. He proved incontestably that there is no effect without a cause, and that in this best of all possible worlds . . . things cannot be other than they are, for, since everything was made for a purpose, it follows that everything was made for the best purpose.
>
> —*Voltaire, "Candide"*

It is difficult for a libertarian conservative not to feel triumphant these days. Not only has the Evil Empire been destroyed, but the welfare state itself is everywhere on the defensive, and giving ground every day. When liberals get elected to office, they act like conservatives, calling for tax cuts, free trade, balanced budgets, less government. Even those Communist societies that have not collapsed seem to have seen the light and are now moving rapidly toward capitalism. This really must be the best of all possible worlds.

Of course there is still much economic misery in the world, destitution, unemployment, people expending their lives at work that gives no satisfaction. But we know what is to be done. More precisely, we know what is not to be done. We must not embark on any program that interferes with the natural workings of the free market, for that, we know, will only make matters worse. What we can do positively at this point is negative. We can work to dismantle the remaining obstacles that prevent the invisible hand from working its full magic.

I would define "Libertarian Panglossism" to be the doctrine articulated in the preceding paragraph. Specifically, it is the thesis that the existing economic evils of the world cannot be mitigated by conscious political actions that alter institutions in such a way as to impede free economic exchange among consenting adults. Any such intervention will have negative consequences that outweigh the positive.

Libertarian Panglossism is a comforting doctrine, at least if one is in a comfortable class. It also provides one with an effective debating strategy. To denounce an interventionist scheme, simply construct a hypothetical case that demonstrates how it might be inefficient. If anyone tries to blame some real-world economic evil on capitalism, just point to the ways in which the existing market isn't

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wholly free. One needn't concern oneself with empirical data or complicated comparisons.

David Ramsay Steele would seem to subscribe to this doctrine. He has no doubt that "the minimum wage produces unemployment" (106). He knows that attempts to redistribute income "will generally reduce efficiency, that is, they will impoverish" (207). He is confident that Adam Smith's invisible hand works so well that "anyone seeking to interfere in the arrangement that results is likely to bring about unexpected and probably deleterious repercussions" (237). He is sure that planning, even planning of the broad outlines of an economy, "cannot work, because there is no broad outline apart from the aggregate outcome of the fine detail" (268). He is certain that the free provision of any good by the government is necessarily inefficient, since "it reduces the satisfaction of people's wants from available resources, just as surely as if physical goods were needlessly destroyed" (287). There is nothing to worry about so far as the future is concerned, for "there is no reason why improvement in the well being of the working masses should not continue indefinitely, as long as a substantially free market is permitted to function" (368).

"Private misfortunes contribute to the general good, so the more private misfortunes there are, the more we find that all is well." That's Pangloss, not Steele, but it is also the reaction of Wall Street (Steele's beloved stockbrokers and bond traders) to the news that unemployment has gone up.

In Voltaire's tale, Candide is expelled from the comfortable country estate where he had been brought up under the tutelage of Dr. Pangloss. He soon finds himself in the real world, engulfed by human and natural catastrophe. Wallowing in blood and trembling with fear and confusion, he asks himself, "If this be the best of all possible worlds, what can the rest be like?" (Voltaire [1758] 1947, 37). Later, he finds Eldorado. There *is* a better world, although it is frightfully difficult to reach.

Steele, to his credit, occasionally allows doubts about Pangloss to cross his mind. He ends his book with a brief appeal for a "critical utopianism," for more "recipes for cookshops of the future" (375), which might suggest more possibilities than the status quo. I applaud this coda and wish only that its spirit might have informed the previous 374 pages.

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NOTES

1. This market socialist economy has been averaging an astonishing 10 percent per year annual growth rate over the past 15 years, during which time real per capita consumption has more than doubled, housing space has doubled, the infant mortality rate has been cut by more than 50 percent, the number of doctors has increased by 50 percent, and life expectancy has gone from 67 to 70 years. I think it safe to say that never before in human history have so many people been lifted from poverty so rapidly. (Data from Gordon 1992 and Nolan 1994.)
2. For a sampling of current views, see Roemer and Bardhan 1993; five distinct models of market socialism are presented there. Stauber 1987, Yunker 1992, and Schweickart 1993 are extended defenses of yet other models.
3. Lange built on the work of Fred Taylor, so the model is often referred to as the Lange-Taylor model. For details, see Lippincott 1938.
4. Specifically, managers of enterprises are to choose the combination of factors that minimizes average cost of production, while managers of entire industries are to fix the scale of output so that marginal cost equals the price of the product (Steele 153).
5. Incensed by Kautsky's lackadaisical treatment of the problem in what was supposed to be a serious work (Kautsky 1907), Mises writes, "Whether one regards the coming of socialism as an unavoidable result of human evolution, or considers the socialization of the means of production as the greatest blessing or the worst disaster that can befall mankind, one must at least concede, that the investigation into the conditions of society organized upon a socialist basis is of value as something more than a good mental exercise, and a means of promoting political clearness and consistency of thought" (Mises [1920] 1935, 88).
6. Hayek (1944) considered it a retreat on the part of advocates of socialism that they were now content to claim that their system could equal the economic productivity of capitalism, resting their case for the superiority of socialism on ethical rather than economic grounds (99). He is not wrong in this regard, but he seems not to have noticed how much he, too, has retreated from the Misesian claim that "in a socialist state wherein the pursuit of economic calculation is impossible, there can be—in our sense of the term—no economy whatsoever" (Mises [1920] 1935, 105).
7. I do not mean to suggest that these possible explanations are wholly independent of one another, or that the information problem might not be intertwined with some of them. I fault Steele for not making any effort to sort out these issues. It is important to understand what went wrong in the Soviet Union, and why. Of course, if one is convinced a priori that socialism is impossible, then one has little motivation to concern oneself with details.
8. Hayek refers to work on these lines "as yet unpublished." He identifies the younger economists as working in Britain, and notes that similar proposals have in fact been published in Germany. I do not know if the British work

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was ever published, nor do I know the identities of any of the economists referred to by Hayek. Neither Lavoie or Steele provides this information.

9. Steele is positively rapturous about bond traders. Marxists, he says, cannot seem to understand "that an unusually successful bond trader is making a greater contribution to human welfare than any hundred farmers or auto workers" (195). He would be well advised to compare a real, quite successful bond trader's account (Lewis 1989) with the Tom Wolfe fantasy (1987) that so inspires him.
10. My model is explicitly designed so as to obviate the necessity of paying interest to private individuals. Under capitalism, huge sums of money flow through the interest channel. In the United States in 1991, personal income from interest totaled $710 billion, a figure approximately equal to total wage and salary income for all commodity-producing industries and more than double corporate pretax profits that year (*Economic Report of the President, 1992*, 323–25). Since most of this flow is, naturally enough, from those with less money to those with more, a market socialist society that does without private interest payments can be expected to be considerably more egalitarian in its income distribution than a comparable capitalist society.
11. It must be said, it is not clear to me that Steele understands the concept of Pareto optimality and its relationship to the basic neoclassical argument about the efficiency of perfectly competitive capitalism. He seems to think that there is only one efficient allocation of resources for a given economy. He calls it a truism "that given resources, knowledge, and preferences strictly imply an optimal allocation" (121). This, of course, is quite false. Not only will differing *initial distributions* of those resources, even when knowledge and preferences are held constant, lead to different optimal allocations; but one cannot assume that the equilibrium point reached under conditions of perfect competition is the *only* Pareto optimal solution. Hence, pointing out, as Steele often does, that a certain outcome will be different from what would obtain under perfectly competitive capitalism does not constitute a proof that this outcome is inefficient. See his lengthy discussion (207–228) of Joseph Carens's proposal for an egalitarian, simulated market for numerous instances of this fallacy.
12. See Schweickart 1993, 98–103, for cases and references. For a brief discussion as to why, if efficient, cooperatives are relatively rare in capitalist economies, see ibid., 238–40. For a fuller discussion of this question, see Miller 1981 and Schwartz 1994.

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Steven Horwitz

KEYNES ON CAPITALISM: REPLY TO HILL

ABSTRACT: *Greg Hill's recent article voices the Keynesian complaint that capitalism produces unemployment because there is no mechanism that coordinates decisions to save with decisions to invest. But resources that are not spent on current consumption are either "invested" as bank deposits or "hoarded" as cash. Deposits are lent out by banks to investors, who are informed by interest rates as to the degree of saving for future consumption that is taking place. And wage/price flexibility, as well as increases in the supply of cash, can avoid declines in real income and employment caused by increased cash holdings.*

In 1946, Henry Hazlitt wrote a little book called *Economics in One Lesson*. The economic "lesson" he referred to was that one must seek out the "unseen" or secondary consequences of human action. In examining the critique of the market offered by Keynes, and faithfully interpreted by Greg Hill ("The Moral Economy: Keynes's Critique of Capitalism," *Critical Review* 10, no. 1), we have to look carefully for the unseen. When we do, we will find that both Hill and Keynes misunderstand the operation of the unhampered market process, particularly its ability to coordinate savings and investment over time. The Keynesian critique of the market's ability to coordinate intertemporally rests on the claim that there is (virtu-

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ally) no relationship between decisions to save and decisions to invest, implying that saving can frequently occur without corresponding acts of investment. If so, then saving takes away from aggregate demand while no other activity steps in to take its place. This claim is false.

Because Keynesians tend not to examine what happens to what is saved, they treat saving as if it means resources are withdrawn and then set on a shelf somewhere. In the real world, however, saving that takes the form of increased deposit balances at banks is channelled into investment through the banking system. Saving that takes the form of "hoards" of cash does not idle resources as long as prices and wages are free to move downward in response, or as long as the banking system is structured so as to respond to the increased demand for cash with increased supplies of it. Keynes overlooked these possibilities, concluding that greater demand for cash would cause a decline in employment and output. The key to a more appreciative vision of the market's intertemporal coordination powers is recognizing that what is not "spent" does not disappear into oblivion but must be devoted to some other use; indeed, it is not spending but saving that drives economic growth.

It is important to note that this more appreciative vision in no way need rest on an equilibrium-oriented understanding of the market. In other words, one can reject the perfect market vision that Hill attributes to neoclassical and (inaccurately) to Austrian economics, yet still make the case that markets are better at meeting the challenge of intertemporal coordination than any likely alternative.[1] All human institutions are prone to error, but markets contain feedback mechanisms that afford them a relatively high rate of error correction.

Must Markets Be Perfect to Be Good?

The difficulties with Hill's argument begin with his description of the vision of the market adopted by "neoclassical and Austrian theory." According to Hill, the Walrasian picture of a perfectly coordinated economy, effected by a hypothetical auctioneer, defines the vision that Keynesianism rejects. When this picture of perfect coordination is extended over time, as in the Arrow-Hahn-Debreu additions to Walras, individual plans are modeled to account for possi-

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ble future states of the world, enabling actors to maximize utility no matter what the future holds. Thus the Walrasian world is one where "the harmonious coordination of individual decisions" is assured and "distributive shares are proportionate to the productive decisions of market participants" (36). For Hill, this vision of the market contains a moral implication: "Each participant's economic fate is the result of the choices she has made within this ideal system of social interaction." In the Walrasian vision we all get the most we can, and we all get what we choose and deserve.

There are numerous problems with this argument, not the least of which is that it is a straw man. It is surely true that the Walrasian vision is the dominant theoretical model informing modern economics. However, when neoclassical economists move away from abstract theory to describe real-world institutions and policies, the best among them (including two whom Hill [36] cites as exemplars of his point: Milton Friedman and P. T. Bauer) recognize the limitations of the Walrasian model. There are, moreover, other alternatives to Keynesian theory that reject Walrasian general equilibrium theory and its perfectionism.[2] One may recognize that the real world of the market will never match up to the perfectly coordinated Walrasian model, yet still allow for the possibility that the market will lead to a high, though imperfect, degree of coordination. To damn the real world of the market because it fails to reach the perfection of the Walrasian model is pointless unless one can also demonstrate the systemic superiority of an alternative. (It is worth noting that nowhere in his paper does Hill subject the political process to the same sort of critical scrutiny he gives the market. That is, he appears to assume that political actors and institutions will perfectly carry out Keynesian policies, never asking whether perhaps they may not suffer imperfections at least as great as those of the market.)

Recognizing the difference between the model of equilibrium and the real world of disequilibrium casts a different light on other aspects of Hill's description of the neoclassical vision. First, to argue that each participant in the market receives remuneration in correspondence to the value of her marginal product requires that the economy is, in fact, in equilibrium. Since it is not, the wages actually paid to individuals may not reflect the value of their marginal products. Although the market will tend to penalize employers who overpay their workers, and employees who do not explore opportunities for higher wages, one cannot assume that wages *always*

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equal the value of marginal products. In fact, real-world incomes are what they are because of some combination of productivity, luck, entrepreneurship, and pure, old-fashioned error. However, we need not believe that one's fate is entirely a result of one's choices in order to appreciate the market's coordinative powers. In fact, it is more proper to say that one's fate in the market, especially one's income, is largely the result of the choices *other people* make as to what they wish to buy and how much they are willing to pay for it. One's choices surely matter, but the choices of others matter at least as much.

A good portion of market income depends upon what Israel Kirzner (1989) has termed "entrepreneurial discovery." Both owners of resources and workers tend to look for new and better ways to deploy their assets or skills so as to make a profit. By seeing opportunities that others have not, either for producing output or filling a labor need, owners and workers can create wealth that did not previously exist. Their incomes result not from the value of their marginal contribution to a known production process, but rather from their alertness to opportunities that previously did not exist. One might "justify" market incomes on the ground that the market prompts more and better discoveries of new resources and production processes, and thus that the incomes earned by the discoverers of these goods encourage the creation of benefits for society as a whole.[3]

In the Walrasian world, there is no room for novelty and true individual judgment. Choices are indeed "automatic" in that once one assumes people are maximizing utility or profits, the "right thing to do" is functionally implied by the data at hand. The assumption that actors have the knowledge necessary to maximize in the way the model demands removes the uncertainty and judgment inherent in all real-world processes, including the market. Coordination in real-world markets is not automatic in the way the Walrasian model is, but rather requires that individuals make genuine choices in the face of uncertainty, and that producers (and financiers, as we shall see) make judgments about what to produce, how to produce it, and who should produce it. These guesses may be wrong, but entrepreneurs who tend to guess right will tend to get rich: that is, they will gain control over more capital in proportion to their ability to make good guesses as to its best future use. Markets are not automatic; they depend on the skilled judgments of

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both consumers and producers, and those judgments may often be wrong. However, admitting that market participants can and do err is not fatal to the case for the market if its processes for error minimization and correction are superior to any likely nonmarket institutional alternative.

Hill (38, emphasis added) contends that, in the neoclassical view, if the public chooses to save more, "resources heretofore engaged in the production of goods to be consumed in the present are . . . *automatically* redeployed so as to increase the production of goods available for consumption in the future." In real markets, however, resources do not get automatically redeployed. They are deployed by entrepreneurs who make choices about what to do and how to do it. Those choices are based on market signals (which can be more or less reliable, and are subject to the same errors that infect all kinds of human endeavor). Hill overlooks these real-world institutional processes, endorsing Keynes's claim that saving would be socially beneficial only "if there was some mechanism, like the imaginary auctioneer . . . capable of coordinating the decisions of those who wished to save with the decisions of those who wished to invest" (39). Such a "mechanism" does exist: the banking system, or more generally, the financial markets. Of course, this mechanism does not perform its task with the perfection of the theoretical auctioneer, but to assert that *no* such system exists in the market is incorrect.

Saving and Borrowing in a Modern Banking System

Before moving to discuss the theoretical issues Hill raises, then, a brief overview of the operation of modern banks is in order. The primary function of banks is to bring together those who wish to save and those who wish to borrow in a manner that makes both activities easier and more profitable. Market actors who do not wish to spend all of their income on goods and services in the present can take a portion of that income and deposit it in a bank. This deposit is in fact a kind of loan to the bank, which in turn promises to pay interest to the depositor and/or to offer the depositor liquidity, by allowing him to "recall" a portion of his loan by writing checks against it. The depositor is able to store wealth unneeded at present and receive a pecuniary and/or nonpecuniary benefit in return.

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The bank receives the deposits of a number of savers and collects them together to lend out to those who wish to borrow. Borrowers, of course, pay the bank interest for the loans they acquire. The bank profits from the difference between the interest earned on its loans and the interest it pays to depositors.[4] Depositors gain interest or checking services at relatively low search costs. In the absence of financial intermediaries like banks, those who wished to save (make loans) would have to search for individuals or firms who wished to borrow. This would be a time-consuming process and lenders would also have to spend resources learning about the risks associated with possible borrowers. By using banks, depositor-lenders dramatically reduce search costs and pass much of the risk and knowledge acquisition costs onto banks. In addition, because banks can make large quantities of diverse loans, their overall exposure to risk is lower than that facing an individual who tried to loan directly to firms or individuals. Borrowers, too, benefit from this relationship, because they would otherwise have to incur search costs in finding lenders; and because, as the banking system encourages saving by lowering the costs of doing so, borrowers have access to more savings than they otherwise would.

Banks effectively allow us to exchange time in the form of money. Savers are willing to defer their consumption until the future, while borrowers wish to consume more now than their current income or wealth will allow. Savers are willing to wait; borrowers want to telescope the future into the present. Banks coordinate the two.

The key to the coordinative powers of banks is the array of interest rates. The interest rates banks charge and pay serve as signals about the apparent willingness of savers to lend and borrowers to borrow. High interest rates suggest that savers are relatively reluctant to wait for the future (thus requiring significant compensation for giving up the power to consume in the present) and/or that borrowers are pushing relatively hard for funds. Low interest rates suggest that savers are comparatively patient (requiring little compensation for waiting) and/or that borrowers are comparatively uninterested in investing in projects that will not produce output until the future. As the time preferences of savers and borrowers move around, interest rates respond by shifting in the appropriate direction, broadly signalling to each group the aggregated desires of the other.

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For example, if the public should suddenly desire to save more, banks will find themselves with more deposits. To attract additional borrowers for these funds, the banks will lower their interest rates, in the same way the seller of any product can induce a greater quantity demanded by lowering its price. The lower interest rate will signal to borrowers that more saving is taking place and that consumers are more willing to wait to consume. At the lower rate, borrowers can invest the loans in processes of production that will not produce output until the future, which coordinates with the increased patience of consumers.

It is important to note two things about this whole process. First, real-world banks and interest rates do not operate perfectly. Banks make mistakes about loans, guess wrong about the interest rates that will maximize their profits, and so on. Nonetheless, in broad terms, they do effectively facilitate intertemporal coordination day in and day out. Second, the ability of banks to charge interest rates that reflect the desires of borrowers and savers, to diversify their loans so as to minimize risk, and to provide an array of loans and services in forms and places consumers want, are all affected by various government regulations, institutions, and policies. If we wish to criticize the historical performance of actual financial markets in facilitating intertemporal coordination, we have to distinguish carefully those features of the banking system that are artifacts of government intervention from those that are inherent to the market.

Interest Rates and Intertemporal Coordination

Keynes objected to the idea of market-driven intertemporal coordination, famously remarking that a decision not to have dinner tonight does not simultaneously involve a decision about what good one will consume instead in the future (quoted, Hill 39). Keynes's objection slides from the accurate observation that an act of saving today does not comprise an order for a specific good in the future to the false claim that more saving reduces the demand for consumer goods without a corresponding increase in the demand for producer goods. This is the fulcrum of Keynes's denial that markets can intertemporally coordinate human choices. Although Keynes rightly notes that there is no market-generated signal about which specific goods should be produced in the future,

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there are *general* signals that saving today requires the production of future goods. These general signals, interest rates, allow entrepreneurs to finance their sometimes competing visions of precisely what people will want in the future.

Keynes argues that increases in savings are responsible for economic depressions, because unfettered markets cannot coordinate savings with increased production for the future, resulting in unemployment in the present. To see why this argument fails, we need to distinguish between three possible forms of saving. If savings take the form of (1) direct loans via the financial market, or (2) indirect loans in the form of increased bank deposits, then these savings are indeed translated into increased investment by the banking system. Although banks and entrepreneurs might make errors about what specific goods will be demanded in the future, laissez-faire capitalism has no systematic inability, in either of these two cases, to coordinate the *aggregate* levels of saving and investment. And if saving takes the form of (3) cash holdings, then flexibility in prices and wages will prevent the burden of adjustment from falling on output and employment.

If I choose not to buy dinner tonight and keep the funds in my bank account, I give the bank control over those resources, which it can then loan out to producers for investment purposes. If I devote the resources that would have been used for dinner to increasing the size of my checking or savings account, then I have made those resources available for the production of future goods. Of course there is no guarantee of perfection in the bank's decision as to the recipients of these resources: an entrepreneur may not produce the precise goods I want in the future. But to expect perfection in this regard would be to hold the market to a standard beyond human capability.

Although it is true that my failure to buy dinner tonight means that "the restaurant owner will likely save less and spend less than she did out of her former higher income" (41), stopping the analysis here ignores the unseen. The fall in the restaurateur's income is offset by more income to the bank (in the form of interest on the additional loans it makes) and to the sellers of the various inputs that the borrowers purchase as part of their new investments. If the resources that would have gone to my dinner are channeled to a company that uses the loan to purchase a new machine, the seller of the machine, and any laborers who are hired to operate it, receive additions to their income that replace the income lost by the

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restaurateur. Rather than paying cooks and farmers to provide me dinner tonight, I am, in effect, paying manufacturers and factory hands who are part of the process that builds an automobile I may buy next year. Keynesian arguments like Hill's focus on what *doesn't* happen to savings, but ignore what *does*.

In response to traditional arguments that interest rates are a function of time preferences and the productivity of capital, Keynes argued that interest rates are purely a monetary phenomenon (such that they could be continually lowered by increases in the money supply). Keynes's monetary theory of the interest rate has been subjected to cogent criticisms from a number of quarters. Most importantly, Kaynes fails to distinguish, unlike many pre-Keynesian economists, between the "natural" rate of interest and the "market" rate. Individuals in their capacity as consumers have implicit preferences about how many present rather than future goods they wish to buy. If the real preferences of the public (as indicated by an unobservable but no less real higher "natural" rate) are for present consumption but the signal facing borrowers (a low "market" rate of interest) suggests that people are very much willing to wait before consuming, then firms will tend to invest in building too many long-term projects, like the capital goods necessary to produce more cars next year, and not enough short-term ones, like dinners tonight. When this intertemporal discoordination makes itself known, a recession will follow. The mismatch between intended saving and intended investment is caused by some systemic divergence between the natural and the market rates. In a large economy where many banks compete to gain the profits derivable from matching market to natural rates, the likeliest cause of a systemic deviation between them is monetary inflation.

Hill (50) argues that it is investment that determines saving, not the other way around. In one sense this is true: if the central bank creates an excess supply of money, and firms respond by borrowing it in order to purchase goods for future consumption, such investment must be financed by an act of saving somewhere. However, this saving is extracted from consumers through a redistribution of wealth created by the excess supply of money. Such "forced saving" conveys to producers a false expectation of the future demand for consumer goods. Producers will eventually discover that they have overestimated future demand; only voluntary saving can drive *sustainable* investments.

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Of course, if we presuppose a general idleness of resources, as Keynesians frequently do, it should come as no surprise that if the banking system creates additional money, investment will be ignited. With idle workers and machines lying around, creating more money might provide the investment funds needed to activate them, and may also reduce their real prices so as to make them hirable given entrepreneurs' current expectations of the value of their marginal products. However, this presupposition leaves unanswered the question of why resources are idle in the first place, given our previous argument about the market's ability to facilitate intertemporal coordination. One possible explanation is that the supply of money has been insufficient to meet the demand to hold it, leading to a slackening of spending and a recession. If so, then Keynesians need to explain why modern economies are prone to such failures, keeping in mind that in almost all such economies, the money supply is produced not by market forces, but primarily by state-run or state-directed central banks. (It is also worth noting that no pre-Keynesian economist would have denied that "reflating" the money supply in the face of an excess demand for money would activate idle resources.)

The role played by interest rates, the banking system, financial markets, and speculators therein is precisely to help us overcome the ignorance of the future with which Keynes is concerned. For example, the problem facing investors is determining the quantity and composition of the possible future demand for their product. There is no way to quantify such information with any precision, but the existence of a reliable interest rate signal provides general guidelines for entrepreneurs. By contrast, starting from the view that interest rates are mere "conventions," Keynesian central bankers would deprive entrepreneurs of any ability to peer into the future, even fallibilistically.

The Role of Wage and Price Flexibility

For aggregate levels of output and employment to maintain themselves when changes in time preferences lead to changes in the intertemporal composition of production, prices and wages will need to be flexible, especially downward, and the money supply must be flexible upward. Consider wages and prices first. Hill (42) argues

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that when the public "over-saves," "the first consequence of this . . . will be an unintended rise in inventories as unsold goods pile up. Firms, realizing they have overestimated demand, will soon cut back production." But why will firms fail to respond to higher inventories by *lowering prices*? Lowering output prices would reduce the value of the marginal product of capital and labor, driving down nominal wages, but it would not reduce aggregate real wages.[5] If more saving is taking place through larger bank deposits, then the withdrawal of funds from consumer-goods industries (providing dinner tonight) will lead to lower prices and wages in these sectors, while the inrush of funds into producer-goods industries (providing the machinery to make cars for next year) will push up wages and prices there. If the necessary flexibility is absent, then unemployment and output reductions must follow.

By neglecting these possibilities, the Keynesian scenario appears to assume that the money supply is fixed and that prices and wages cannot fall. Given those assumptions, greater savings must reduce aggregate output and employment. Hill (42) writes that "a reduction in one person's expenditure during a given period entails, by logical necessity, a corresponding reduction in someone else's income during the same period." That is surely true of nominal income, but it is not "by logical necessity" true of real income if prices, wages, and the money supply are flexible. Thus, where increased saving is mediated by the banking system, it results in a shift of resources from consumer-goods industries toward capital-goods industries, requiring that prices and wages fall in the former and rise in the latter.

Sometimes, however, people may manifest a desire to postpone consumption not by increasing their bank deposits, giving the banks funds that can be lent out as investments in future production, but by trying to increase their stores of cash. This can produce three reactions: (1) the monetary system can provide additional cash for people to hold; (2) the price level can fall; and/or (3) the level of output and employment can fall. The Keynesian argument Hill repeats assumes that the third scenario is the only possibility. If either the first or second happens to a sufficient degree, there is no reason to expect the level of output and employment to fall when the public suddenly prefers cash. Let us explore the first two alternatives more closely, then.

A properly functioning laissez-faire monetary system should be

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able to respond to an increased demand for cash by supplying what the public wishes to hold, and in so doing, avoid any adverse macroeconomic consequences.[6] Cash is not fundamentally different than other goods or services; if the public wishes to hold more of it, there is no reason that the laws of supply and demand should take a holiday. Keynes assumed that cash is "barren" because it provides no yield to the holder, such that holding cash was socially wasteful. If one defines "yield" to be some sort of financial return, then Keynes was right, but the same is true of any other good or service. Compact disc players do not yield a pecuniary return, yet people choose to hold "stocks" of them because they provide a service—the playing of music. Cash is no different, in that it provides the service of being available to buy things. By Keynes's logic, fire trucks standing in fire stations are "doing nothing" and yield no benefits. But they provide the benefit of being available for use when needed. In this way, cash is like any other good or service and the monetary system should produce it to the degree the public is willing to hold stocks of it.

If the monetary system provides additional cash when the public wishes to hold more, it replaces the lost spending of the public with additions to the money supply, preventing either falling prices or falling output. If the monetary system fails, however, and the supply of cash is not increased, then prices must fall and/or output and employment must fall. With price and wage flexibility, an uncompensated increase in the demand for cash will necessitate varying downward adjustments in prices and wages in all industries (not just consumer-goods industries). If those adjustments can take place, then employment, real income, and real output will not be affected. If, however, prices and wages cannot make this general downward adjustment, then the reduction in aggregate demand will cause declines in employment, income, and output.

It is worth recalling in this connection that the capitalist economies of the 1920s and 1930s were far from unfettered by state supervision. All capitalist economies had central banks (in the United States, the Federal Reserve System) or similar regulatory regimes, and were bereft, especially in the American case, of a sufficiently flexible wage structure. Indeed, U.S. government policy in the aftermath of the stock market crash in 1929 was designed to *prevent* nominal wages from falling. A recent study by Richard Vedder and Lowell Gallaway (1993) shows that

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> the failure of money wages to fall in the downturn beginning in the fall of 1929 was largely a consequence of public-policy intervention by President Hoover and his political allies. As a consequence of this intervention, real wages rose rather than fell, and unemployment increased to previously unattained levels. The Great Depression was not a tragic example of market failure as is conventionally believed, but rather was an example of government failure. (89–90)

Keynes failed to recognize the role interest rates play in coordinating the demand for future consumption with the supply of present investment because he made the common mistake of examining only the immediately apparent consequences of economic actions. As Hazlitt pointed out, this mistake is exemplified by those who, in response to seeing a brick thrown through a storekeeper's window, revel in the thought of the new employment created for janitors, glaziers, police detectives, judges, and jailers. These people will, with the income they derive from this act of vandalism, buy more goods and services, increasing the incomes of their sellers, and so on. It begins to look like breaking windows is good for economic growth.[7]

The fallacy here is the failure to look deeply enough. The original storekeeper does indeed spend, say, $100 repairing the window, but had it not been broken, he would have had a working window *and* the $100, which he could have spent on something else. The money spent on replacing the window would have otherwise been spent on, say, a new suit of clothes. The difference between the two cases is that the resources spent on fixing the window only bring the storekeeper back to where he was, while the $100 he would have spent on a new suit would have satisfied a previously unsatisfied preference. Thus breaking windows does not add to wealth any more than earthquakes, floods, or wars do, because the resources directly expended to repair the damage merely brings us back to where we were before.

Spending and the Sources of Wealth

Hill also endorses the Keynesian view that the poor are the engines of economic growth, since they spend a higher proportion of their income than the rich, driving firms to invest, produce, and employ:

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> Since it is spending, not saving, that generates income, and since the poor spend a larger percentage of their income than the rich, it follows that a nation's economic prospects can sometimes be improved by a redistribution of income from those classes which can find no further outlet for expenditure to those classes whose immediate needs can only be met by additional spending. Moreover, since it is precisely such an increase in spending that prompts firms to invest, a more equal distribution of income is not only apt to result in more current consumption, it can, if some resources are idle, also increase investment spending . . . because increased consumption and increased investment typically go hand-in-hand. (43)

Is it true, however, that spending generates income? To believe that it does, we must overlook the question of *where the power to spend comes from.* It is not spending that generates income, but income that generates the ability to spend. Income, as W. H. Hutt (1975, 18) argued, derives from the production of assets that can be sold at existing market prices.[8] High wages per se are not the cause of spending. Spending presupposes the income earned by owners of productive goods or services priced to sell. That is, wage income is generated when a worker prices her labor services such that they are affordable in the labor market. Her subsequent purchases of other goods and services increase the productivity, and thus the wages, of asset owners in those industries. Similarly, the productivity of capital assets priced so as to clear the market is what generates their income, not the act of passing money from consumer to producer. Consumers can only spend the monetary value of their asset holdings, which derive from what they have previously produced and sold.

If the act of spending of money generated income, then countries with high rates of inflation, as measured by the quantity of money in circulation, should have the highest per capita incomes and growth rates. The evidence suggests otherwise.[9] The line of causality is from productivity to wages to income to spending, not the other way around. Spending does not create jobs; being a productive worker who can fill a job profitably creates the ability to spend. This is not a chicken-and-egg problem. The process must start with production and the income it generates. The productivity of capital machinery and of human capital, the existence of which results from saving (not the spending of money), has created the elevated wage rates and previously unimaginable wealth of the West.

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Spending power has to come from somewhere—namely, from increases in productivity.

Hill follows Keynes not only in believing that spending creates income, but that it creates investment. This is problematic in several ways. First of all, it ignores the cost of investing. While greater spending for a specific good may well raise the expected returns from investing in its production, investors must also consider the cost of borrowing the resources to undertake that investment. Automobiles may be in great demand, but if the cost of the funds necessary to build automobile factories is too high to produce a positive net yield from car sales, the high demand for output will not lead to a high level of investment. Second, greater demand for one good can stimulate investment in that good only by drawing resources and, therefore, investment away from other goods. By the same token, only potential spending on consumer goods deriving from new income created through increased productivity can raise the total demand for investment, rather than just reshuffling its previous level. Attempting to stimulate investment demand by fiat (through inflation), then, will bid up input prices, frustrating the attempt to increase profits and income.[10]

On the other hand, no pre-Keynesian economist would have denied that *if resources are idle*, increased demand for consumer goods can stimulate the demand for investment. The question is the cause of idle resources. Vedder and Gallaway document one cause of idleness: a general overpricing of labor caused by government policy. Another possibility is investor-entrepreneurial error. In a laissez-faire economy, however, when entrepreneurs make erroneous investments, they will tend to be liquidated because of their unprofitability. Idleness caused by entrepreneurial error would show no systemic patterns, being an irremovable feature of a world of uncertainty and fallible human beings. Similarly, individuals or companies may price labor or capital resources too high to sell, but such errors will be random and, in the absence of policies which prevent flexibility, they will tend to be corrected under penalty of unemployment or bankruptcy. What lends unwarranted credibility to the Keynesian project is its assumption—plausible (though incorrect) during the Great Depression, when Keynesianism first gained popular acceptance—that idle resources are the norm, or that a systemic, economy-wide idling of resources is a likely product of laissez-faire capitalism.

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Speculation and Capitalism

Hill also argues that, in the past, the lack of markets for ownership rights meant that owners and firms were tied together for the long run, forcing them to have longer time horizons. The stock market, however, has weakened this tie, so that today, such long-run relationships are less frequent. Moreover, the efficiency of the stock market means that speculators are always on the prowl for quick profits resulting from movements in stock prices. Since those prices largely reflect the expectations of other market participants, the way to profit in the stock market is not by picking stocks that produce products people will want to buy, but stocks *others* think will perform well. Of course their expectations are simply expectations about everyone else's expectations, so stock prices are moved, according to Keynes, by mass psychology rather than underlying fundamentals. As Hill (55) interprets Keynes:

> Capital gains . . . do not necessarily accrue to those who have performed a useful service in accurately forecasting the future needs of households and businesses, but often times fall to those who have accurately predicted how other investors will assess a particular stock, a talent which provides no useful service at all.

It is undoubtedly true that in the short run, many stock prices move around as traders attempt to cash in capital gains. However, not all stock owners are in the market for short-term gains and even those who are recognize that stock prices do respond to fundamentals such as debt/equity ratios, quarterly profit reports, and the like. Some stock owners are more interested in the voting rights and management influence that comes with stock ownership than the quick gains that can be made through short-term turnover. Stock is, after all, a form of ownership and thus a claim on the net worth of the firm. If a firm's net asset value is $1 million and it has issued 100,000 shares of stock, each share is worth $10. The actual market price will diverge from that number due to diverse expectations about the firm's future performance. But, should the firm liquidate, each share owner would be entitled to a pro rata share of the firm's net worth. Thus stock prices are not created out of thin air. They may indeed fluctuate in the short term as expectations of expectations change, but the value of stock is ultimately

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anchored to the net worth of the firm. The share owner's stake as a residual claimant gives him reason to care about the long-run performance of the firm.

This concern sometimes plays itself out in a corporate takeover, where one individual or group thinks the targeted firm could be run more efficiently and produce more profits under different management. One way to install new management is to buy up stock and thus voting rights. In the case of a takeover, the purchasers need to hold the stock for a period of time long enough to put their new management plans into action. Selling out in three days because the stock rose slightly on the news of the intended takeover will not get them the larger long-terms gain they believe can be made through better management. Those efficiency gains will manifest themselves in an increase in the net worth of the firm and, therefore, the value of its stock.

Normally, firms do not liquidate and stock owners never receive a precise pro rata share of the net worth of the firm. When a stock owner sells under normal circumstances, there has to be a buyer on the other side of the transaction willing to part with a monetary value that is greater than the seller's assessment of the value of the stock. It is these divergent expectations of future performance (buyers are relatively more optimistic than sellers) that create stock-market trades in the first place. As with entrepreneurship, the market offers great rewards, in terms of control over capital, to those traders whose expectations are more accurate.

In less normal circumstances, such as when a firm is being taken over, the buyer, in this case the acquiring firm, usually offers a premium price for the firm's stock. A takeover is a form of liquidation in a sense, as the owners of the acquired firm sell out their ownership stake for cash and the firm ceases to exist as an independent entity. Here too, the premium price is still related to the perceived potential value of the acquired firm's assets. The buyers are "betting" that they can generate more value out of those assets than is the case at the moment. Current owners face the choice of selling out now at the premium price or staying along for the ride with the new management. It is because stock ownership is a legal claim to a pro rata share of the firm's net worth that stock prices are not just epiphenomena of mass psychology but, instead, have some connection to the firm's underlying fundamentals.

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If Keynesians such as Hill wish to condemn capitalism, they will have to do it on grounds other than Keynes's denial that markets can produce intertemporal coordination. One can, and Keynesians often do, point to the recessions and depressions experienced by market economies as apparent evidence of Keynes's claim. But, as I have argued, markets do contain institutions that produce intertemporal coordination. The history of really-existing capitalism is full of various government interventions (most notably by central banks) into those coordination processes. Because these interventions can prevent markets from coordinating the preferences of savers with those of investors, we have to be very careful to distinguish whether historical examples of apparent market failure are the result of some inherent inability of markets or of the deleterious, if unintended, consequences of government intervention.

NOTES

1. Roger Garrison (1986) has thus viewed the Austrian-school position as occupying a "middle ground" between the perfection presupposed by general equilibrium theory and the systematic discoordination posited by Keynesianism.
2. Foremost among these is the Austrian school, which, contrary to the suggestions made by Hill, neither accepts that the Walrasian model describes the real world, nor that it is very useful in understanding real-world economic processes. Nonetheless, Austrians generally believe that the market, though imperfect, does a better job at most, if not all, economic tasks than does the political process. For overviews of the Austrian perspective which reflect these views, see Lavoie 1985, Boettke, Horwitz, and Prychitko 1994, Vaughn 1994, and O'Driscoll and Rizzo 1996.
3. This view is defended by Israel Kirzner (1989).
4. Because the interest earned on loans is the primary source of revenue for banks, bankers have powerful incentives to make sure they make loans to firms that will guess correctly about which specific goods will be demanded in the future. If they extend credit to firms that guess wrong, those firms will not generate the revenue needed to pay back the interest, or even the principal, on the loans.
5. Whether prices and wages can ever be flexible enough to avoid reductions in output and employment in the face of an excess demand for money is not clear. Some economists have harkened back to the pre-Keynesian monetary theorists and have begun to argue that wage and price rigidities are severe enough so that a policy of adjusting the nominal money supply

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to changes in demand is superior to trying to allow the price level to fall. See Yeager 1986 on the problem of sticky prices, and Selgin 1988 and Horwitz 1996 on the role of a flexible money supply in avoiding those problems.

6. Many have argued that a truly laissez-faire banking system would take the form of so-called "free banking." On the relationship between Keynes and free banking, see Horwitz 1989. General works on free banking include Selgin 1988, Dowd 1989, Glasner 1989, and White 1996.
7. Ironically, the ultimately unproductive activities of, in this example, the janitors, glaziers, detectives, etc., do count toward GDP "growth." One major problem with using GDP as a measure of wealth is that it does not distinguish between expenditures that create wealth, those that transfer wealth, and those that simply restore wealth to its previous level. The expenditures needed to clean up after a building is burned down in a riot are not distinguished from those that create new products or services. Such concerns are of paramount importance in making judgments about the health of economies suffering from inflation, which induces all sorts of expenditures that do not create wealth but simply try to protect it from the effects of depreciation.
8. Hutt's argument here is, as he recognizes, "pure orthodoxy" in its derivation from various pre-Keynesian economists, especially J. B. Say. See Hutt's 1979 critique of Keynesianism.
9. On the relationship between inflation and economic growth see Fischer 1991 and Barro 1995. Of course, all such statistics need to be read in light of the point made in n7 about the way in which GDP figures overstate the health of inflation-ridden economies.
10. See Hayek's (1941, 433–39) excellent discussion of what he calls "Mill's fourth postulate."

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Greg Hill

CAPITALISM, COORDINATION, AND KEYNES: REJOINDER TO HORWITZ

ABSTRACT: *In the ideal market of general equilibrium theory, choices are made in full knowledge of one another, and all expectations are fulfilled. This pre-harmonization of individual plans does not occur in real-world markets where decisions must be taken in ignorance of one another. The Austrian school grants this, but claims that real-world price systems are nonetheless effective in coordinating saving and investment decisions, which are motivated by disparate considerations. In contrast, Keynes held that without the pre-reconciliation of individual plans, investment and employment would be less than optimal, and the resulting distribution of income arbitrary and inequitable.*

In "The Moral Economy: Keynes's Critique of Capitalist Justice" (*Critical Review* 10, no. 1), I drew from Keynes in arguing that capitalist economies are subject to coordination failures that cast a troubling shadow over visions of the market in which individuals choose their own fate, and in which income is distributed according to each person's productive contribution. In his reply, Professor Horwitz develops five main points: 1) the banking system and the rate of interest assure that saving and investment are effectively harmonized; 2) prolonged periods of unemployment cannot occur if

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wages and prices are flexible; 3) money is not different from other goods; 4) income is the source of expenditure, not vice versa; and 5) real-world markets may be imperfect, but they are superior to every alternative. I shall take up these points in turn.

The Coordination of Saving and Investment

Horwitz contends that Keynesians believe saving and investment are subject to coordination failure because they "treat saving as if it means resources are withdrawn and then set on a shelf somewhere" (354). "In the real world," Horwitz reminds us, savings are usually deposited with banks and "channeled into investment through the banking system" (ibid.). Thus, he concludes, "what is not 'spent' does not disappear into oblivion, but must be devoted to some other use" (ibid.).

Is it possible that in explaining how saving and investment can "get out of gear," Keynes forgot that people deposit their savings in banks and that banks lend these savings to entrepreneurs who invest? No, Keynes was aware that banks direct savings into investment and that when the public instead hoards its savings in cash, prices fall. But he did not find these mechanisms sufficient to balance saving and investment at a level that assures full employment. We can see why they are insufficient by taking a critical look at Horwitz's "more appreciative vision of the market's intertemporal coordination powers" (354).

According to this vision, if individuals reduce their consumption spending and deposit their savings with banks, the supply of loanable funds will rise, the interest rate will fall, and banks will increase their lending. The hidden premise in this sequence is that an individual's increased saving necessarily increases *total* saving, for it is the presumed rise in *total* saving that reduces the rate of interest. Horwitz does not seem to realize that this assumed rise in total saving, which he takes as a given, is precisely what is at issue in this controversy. For if, by contrast, the individual's act of saving, literally "not spending," reduces the income and saving of others, there may be no increase in total saving (though there will surely be a decrease in total income).

Horwitz is unimpressed by Keynes's demonstration that the act of saving reduces current consumption without communicating

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any intention to purchase goods in the future. Yet the nexus Horwitz wishes to establish between saving and investment is an illusion, which can be disclosed by examining his version of Keynes's parable about the diner who foregoes his regular meal at the neighborhood restaurant in order to augment his savings. Keynes's point is that the abstinent diner's increased saving may be offset by the decreased saving of others, in this case the restaurant owner, her employees and suppliers, whose income and saving will fall as a result of the decline in dinner sales. Horwitz allows this much, but goes on to argue that "the fall in the restaurateur's income is offset by more income to the bank (in the form of interest on the additional loans it makes) . . ." (360). Horwitz's accounting is, however, incomplete because he has neglected to mention that while the *diner's bank* may eventually enjoy more income from *its* increase in deposits and loans, the banks serving the restaurateur, her employees, and her suppliers, will suffer a reduction in *their* deposits, loans, and income.[1] Since the diner's act of renunciation brings about no increase in total saving, nor any increase in the total stock of bank deposits, it will not bring about any reduction in the rate of interest either.[2] Consequently, this act of saving will not signal any intention to buy goods in the future, and thus there is no reason to think it will be offset by a corresponding act of investment.

When Horwitz says, "if the public should suddenly desire to save more, banks will find themselves with more deposits" (359), it is clear he has missed Keynes's message altogether. For if members of the public "should suddenly desire to save more"—say, twice the dollar amount they are now saving out of their current income—the result will *not* be a piling up of bank deposits. Quite the contrary, these households will soon discover that the level of income they were earning prior to cutting their expenditure is not forthcoming. The reason for their disappointment is not far to seek: when one person reduces her spending, another person's income must fall by an equal amount, income and expenditure being two sides of the same coin.[3] The issue of whether banks can effectively channel "savings" into investment is moot in this case because, with a sudden reduction in expenditure and income, there will be no increased saving "taking place through larger bank deposits" (363).

The assumption that permits Horwitz to reach many of his conclusions—that aggregate saving is just the sum of saving by individuals—is also implicit in the conventional view that inequalities of

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wealth and income are favorable to high rates of saving and investment.[4] Since the rich save a larger percentage of their income than the poor, then, on Horwitz's account, the average rate of saving should rise whenever wealthy households command a larger share of the nation's income. But the postwar record of the advanced economies suggests that greater inequality of income may actually *reduce* the rate of saving. In the United States, the personal saving rate reached its postwar peak during the early 1970s, when income inequality was near its postwar low; while personal saving plummeted to its postwar nadir during the 1990s, when the inequality of income reached its postwar high.[5] Similarly, during most of this period, the economies of Western Europe experienced higher rates of saving and less inequality than the United States.[6] These statistics are not sufficient to refute the conventional theory of saving because many economic changes took place during this interval, but they should raise doubts about both it and the orthodox justification of inequality that is based upon it.

Let us turn to Horwitz's contention that, by signaling "the apparent willingness of savers to lend and borrowers to borrow" (358), the rate of interest effectively coordinates the flows of saving and investment. On this view, if the public increases the flow of saving it is supplying to the credit market, a fall in the interest rate will induce firms to increase their flow of investment expenditure. One of the reasons the rate of interest cannot effectively play this role is that the flows of new saving and investment are relatively small in comparison to the massive stock of pre-existing financial assets. In 1992, for example, personal saving in the United States totaled about $450 billion, while private holdings of financial assets totaled about $12 trillion, that is, about 27 times annual saving and about 108 times quarterly saving.[7] If a preponderance of those who hold these assets decide to sell bonds because they believe interest rates are going to rise and bond prices are going to fall, their fears will overwhelm any increase in the flow of saving. Horwitz does not come to grips with this problem (he does not even mention it), but as long as the interest rate remains tethered to the expectations of those who hold the pre-existing stock of financial assets, it cannot effectively carry out the task assigned to it by the neoclassical and Austrian schools.

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Unemployment and Flexible Wages and Prices

Horwitz does not think that when planned saving exceeds planned investment—that is, when producers thrust upon the market more goods than households wish to buy—unemployment will result. Instead, he contends that prices and wages in the consumption-goods sector will fall, "while the inrush of funds into producer-goods industries (providing the machinery to make cars for next year) will push up wages and prices there" (363). In thinking through the plausibility of this scenario, the following question presses itself upon us: will automobile manufacturers order additional production facilities from "producer-goods industries" when the demand for cars is falling and auto manufacturers have excess capacity?[8] It seems doubtful. Moreover, since the prices of producer goods depend on expectations about future demand, and since these expectations are heavily influenced by current demand, the prices of producer goods will typically fall, not rise, in response to a sharp reduction in consumption.

Horwitz is committed to the notion that flexible wages and prices will keep resources fully employed and thinks Keynesians must assume fixed wages and prices to explain the possibility of persistent unemployment (363). In fact, Keynes thought wages were too flexible and advocated, as matter of policy (and not as a statement of fact), that wages should be less flexible. Although Keynes did not quite put it this way, an individual firm's decision to cut wages, like a single household's decision to cut spending, poses a collective action problem. While every business prefers to pay lower wages to *its* employees, the collective outcome of a universal reduction in pay is a corresponding reduction in the demand for every firm's product.[9]

Horwitz accuses me of attributing to the neoclassical and Austrian schools an "abstract theory" of the perfect market, which does not take account of the fact that when members of these schools "describe real-world institutions," they "recognize the limitations of the Walrasian model" (355). Yet Horwitz's own claim that "employment, real income, and real output will not be affected" (364) by a general decline in prices is such a marvelous example of *not* recognizing "the limitations of the Walrasian model" that I am reluctant to spoil it with any commentary. Perhaps it will be sufficient to

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point out that when there is a significant decline in wages and prices *in the real world*, many firms and households with fixed debt-service obligations, undertaken when prices and wages were higher, will be unable to meet their financial commitments. A round of bankruptcies will then reverberate throughout the economy as each debtor's inability to repay outstanding loans creates financial problems for creditors who, themselves, have bills to pay. I am inclined to say that an economist could *only* claim that "employment, real income, and real output will not be affected" by this process *if* he is thinking in terms of the perfect market of Walras instead of the actual economy in which debts are incurred and wage agreements are made.

The Nature of Money

Horwitz does not grasp how a sudden increase in the public's demand for liquidity can reduce output and employment because he has no idea why people wish to hold liquid assets. According to his account, "people may manifest a desire to postpone consumption not by increasing their bank deposits . . . but by trying to increase their stores of cash" (363). Unfortunately, Horwitz does not trouble to tell us *why* people wish to hold more cash when they can hold interest-bearing securities instead. If he did, his time-preference theory of the interest rate would fall to pieces.

A decision about *where* to place one's savings depends on one's forecast of future asset prices. If a person is convinced the prices of stocks and bonds are going to fall, he will sell his securities and increase his holdings of money or near-money, e.g., short-term Treasury Bills. Once we are clear about why the demand for money might suddenly rise, it is easy to understand why this increased demand for liquidity can throw people out of work. If bond traders become convinced bond prices will fall, or even if they become less certain about the future direction of bond prices, long-term interest rates must rise in order to compensate for the heightened perception of risk. As Keynes once put it, the rate of interest "is the measure of the degree of our disquietude" (1937, 219). And the consequence of our sometimes deep "disquietude" will be an increase in unemployment because the rise in interest rates that is necessary to mollify the anxiety of prospective bondholders will si-

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multaneously choke off the demand for investment goods and the labor that produces them.

Horwitz misses all this because he is convinced that "cash is not fundamentally different than other goods or services," and that Keynes mistakenly "assumed that cash is 'barren' because it provides no yield to the holder" (364). Actually, Keynes assumed no such thing; he regarded money as a store of value that allows its holders to postpone decisions until they are more confident in their forecasts of future prices, an advantage that is not provided by ordinary goods such as Horwitz's stocks of compact disk players and fire trucks (ibid.). Although money is not "barren" for those who hold it, an intense demand for liquidity can leave otherwise productive assets "barren"—that is, idle. When the demand for an ordinary good increases and its price rises, labor can be employed to produce more of it. But when the demand for money increases, private enterprise cannot (legally) employ labor to increase *its* supply.[10] In this respect, the "laws of supply and demand" do, indeed, "take a holiday" (ibid.).

Sometimes "our disquietude" can be counterbalanced by the central bank, and in a manner that avoids the pain and suffering caused by plunging wages and prices. If the banking system increases the supply of money, *and* the preference for liquidity remains unchanged, interest rates will fall, and investment spending *may* then rise. Although Keynes expressed measured optimism about this possibility, and certainly preferred it over the alternative of allowing wages and prices to fall until people again wish to buy, he never said interest rates "could be continually lowered by increases in the money supply" (361). Rather, Keynes held that the central bank faces the same impediment that prevents market forces from driving the interest rate below a certain level, namely a convention or opinion as to the rate of interest that is "normal" or "durable" (1936, 203–4). The further the actual rate of interest falls below the "normal" rate, the stronger becomes the fear that interest rates will rise (and bond prices fall), which constrains the central bank's power to push the rate of interest below a certain point.[11]

Horwitz wishes to escape the comforting confines of the perfect market in favor of the real, rough-and-tumble economy, but he is unwilling to pay the full price of admission—the acknowledgment of radical uncertainty and the recognition of money as an imperfect means of coping with it. To hold cash is to take refuge from uncer-

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tainty. "But to take refuge from uncertainty is to take refuge from enterprise, from the giving of employment" (Shackle 1988, 38). To comprehend this point is to exit the Austrian market and enter its Keynesian counterpart.

Income, Expenditure, and Wealth

The section of Horwitz's Reply devoted to showing that income "generates the ability to spend" (366) is marred by a semantic confusion that could have been avoided had he remembered that for every dollar of income received there must be a corresponding dollar of expenditure. Thus, when Horwitz says that income "derives from the production of assets that can be sold," we must remind him that this sale necessarily involves a purchase (ibid.). And when he says that "wage income is generated when a worker prices her labor services such that they are affordable," we must point out that this worker's "wage income" entails, by logical necessity, a payment equal to the wages received (ibid.). And, finally, when Horwitz summarizes his view by asserting that "the process must start with production and the income it generates," we must insist that such "income" will only be forthcoming if the output of the production process is actually bought (ibid.).

Horwitz slips into this accounting quagmire because, in his impatience to show that spending depends on income, and income on production, he forgets that I said, "it is spending, *not saving*, that generates income" (Hill 1996, 43, emphasis added). Even from within Horwitz's own theory, savings will not generate income unless they are channeled by the banking system into investment *spending*. The real issue lurking beneath these relationships among income, expenditure, and saving is whether there can be persistent unemployment in a market economy. If, as Horwitz (usually) assumes, resources are fully employed, then increased spending will drive up prices, which is consistent with Keynes's own view (1936, ch. 21). If, on the other hand, some resources are idle, then additional spending, whether financed from cash balances or new loans, will raise aggregate income, a result Horwitz himself admits when he writes that "increased demand for consumer goods can stimulate demand for investment" (367).

In either case, an increase in spending need not be derived from

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what the purchaser has already earned, or, for that matter, from what anyone else has already earned. Expenditure for plant and equipment, for example, can be financed by a loan that does not represent anyone's "savings," but is simply a line of credit extended by a bank to a firm. Horwitz's "modern banking system" is primitive insofar as the total amount of credit made available by this banking system does not exceed the total stock of savings deposits. Contemporary banks create credit in excess of savings, which means that "savings proper" need not precede investment. The firm's investment expenditure will generate an equivalent amount of income, and if the income recipients of this investment expenditure spend a portion of their income on consumption goods, then income (and expenditure) will continue to rise (via the multiplier) until total additions to saving are equal to the original investment expenditure.[12]

When Horwitz says investment in one good can only occur "by drawing resources, and therefore, investment away from other goods" (367), he is of course assuming there are no idle resources. We soon learn, however, that resources can become idle because "entrepreneurs make erroneous investments," but also that these errors are "random" and "will tend to be corrected under penalty of unemployment or bankruptcy" (ibid.). Horwitz is evidently thinking of the case in which an entrepreneur has overestimated the demand for her product and, failing to receive the expected sales revenue, must fire her employees and default on her debt. Had Horwitz only raised his eyes from the individual case before him to survey the economy as a whole, he would have noticed that entrepreneurs *in the aggregate* sometimes overestimate demand and must reduce their payment of wages and debt service, but that this reduction in expenditure, far from "correcting the error," will exacerbate its unfortunate consequences.

Perfect Markets

Horwitz acknowledges that real-world markets are imperfect, but contends that they "are better at meeting the challenge of intertemporal coordination than any likely alternative" (354). I am going to address this point by proposing a couple of institutional alternatives that, arguably, would do a better job of coordinating saving and in-

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vestment than existing market arrangements. But first I want to say something about the differences between the Keynesian and Austrian views of the real-world market economy. Let me begin by noting that Keynes and the Austrians both reject the idealized market of general equilibrium theory as a fruitful model for understanding real-world market economies. In the absence of a general pre-reconciliation of choices, the future is no longer certain, decisions must be made in partial ignorance of their consequences, and markets become speculative. Although this rejection of full Walrasian equilibrium is common ground, the Austrians maintain that the errors made by market participants, which inevitably arise when actions are taken in ignorance of one another, are random errors, "an irremovable feature of a world of uncertainty and fallible human beings" (367). Moreover, the Austrian school also holds that the discoordination of choices, which results from these random errors, is self-correcting, the mechanism of self-correction being the decentralized price system that Horwitz urges upon us in the form of "flexible wages and prices."

Keynes rejected both of these propositions. To begin with, he held that real-world markets are prone to suboptimal outcomes which are systemic and cannot be attributed entirely to the random errors of entrepreneurial decision making. In particular, Keynes was convinced that it is more likely that planned investment will fall short of planned saving than vice versa. One reason for this bias toward underinvestment is that whenever there are unemployed resources, the social return to investment will exceed the private return because investment expenditure will generate external benefits through the action of the multiplier.[13] Thus, while resources may *become* idle as a result of entrepreneurial error, there is no reason to expect that, once resources *are* idle, decisions taken by profit-maximizing firms will produce an efficient outcome, since these firms have no interest in costs or benefits that accrue to others.

The second disagreement between Keynes and the Austrian school is that Keynes believed that certain kinds of error are *not* self-correcting, or, at least, are not self-correcting in a timely and efficacious manner. Thus, where Horwitz sees falling prices as a painless solution to heightened liquidity demand, Keynes sees expectations of a further decline in prices—expectations that prompt buyers to postpone purchases—thereby pushing prices down even further. And where Horwitz sees an "inrush of funds into the pro-

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ducer-goods industries" when there is slack demand for consumer goods, Keynes sees a decline in the prospective return to investment in new capital facilities and, hence, a reduction in investment expenditure.

Although "Keynesian" economic policy is typically equated with the use of monetary and fiscal policy to offset these deflationary tendencies, Keynes himself was more interested in stabilizing aggregate investment expenditure and called for "the somewhat comprehensive socialisation of investment" (1936, 378). A steady flow of investment spending, at a level greater than that which ordinarily prevails in the capitalist economies of the West, would secure two objectives. First, it would ensure the full employment of society's resources. And second, this higher level of investment, by increasing the size of the capital stock, would eliminate that portion of the return to capital that is due solely to its scarcity, thereby reducing the inequality of wealth and income.

I noted above that when there are unemployed resources, the level of investment will be less than optimal because of the divergence between the private return to investment and the social return to investment, which encompasses the external benefits generated by the multiplier. Insofar as the state undertakes investments directly, it internalizes these multiplier benefits because they accrue to the nation as a whole (assuming a closed economy). I do not expect that a permanent increase in the level of public investment would be well received by those suspicious of the state, even though the divergence between private and social returns means that, if investment decisions are left entirely in private hands, the level of investment will *necessarily* be suboptimal.

Let me suggest, then, two alternatives that do not supplant the market, but expand its scope. The first one envisions a computer network linking the economy's thousand largest firms with a Walrasian auctioneer at the center of the network. Each firm would initially inform the auctioneer as to the different quantities of investment expenditure it would be willing to undertake given alternative volumes of investment spending undertaken by all the other participating firms. Using this information, the auctioneer would propose alternative combinations of investment expenditure until each firm agreed to a particular level of spending, given the spending of all other firms. To assure compliance, firms that failed to meet their spending commitments would be subject to tax penal-

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ties, and the revenue from these penalties would be transferred to firms meeting their commitments. The creation of such a coordination arrangement would increase the level of aggregate investment by reducing the variance in aggregate demand, which determines in large measure the degree of investment risk. Although, in this scheme, the public's willingness to wait does not determine the level of investment (saving being a residual in Keynes's theory), there is no "forced saving" (361) either; households remain free to save as they wish.

I want to introduce the second alternative by noting that much of the uncertainty associated with investment arises from the lack of a complete set of futures markets. Indeed, it is the absence of such markets, and the suboptimal level of investment that results therefrom, that led Kenneth Arrow, an economist who has given us perhaps the most precise description of the ideal market, to advance "a cautious case for socialism" (1982). Yet, while firms have only a few futures prices to guide their investment decisions, stockholders are at least afforded the opportunity to reduce their risks by holding a diverse portfolio of assets. By contrast, workers have almost no opportunity to insure against variations in their wages or in the value of their human capital. "While property owners can spread their risks by putting small bits of their property into a large number of concerns, a worker cannot put small bits of his effort into a large number of jobs" (Drèze 1989, 41). To afford workers greater opportunities for self-determination, imagine the creation of a futures market in which workers could insure the value of their human capital by purchasing an insurance policy that paid a benefit in the event the average wage of their occupational group fell below a certain threshold. Similarly, imagine new insurance markets in which people could hedge against changes in their income that were due to changes in national income over which individuals have no control (see Shiller 1993). The establishment of such "macro markets" would accomplish three objectives: 1) a more efficient allocation of risk-bearing; 2) a reduction in the volatility of aggregate demand, thereby creating a more attractive environment for investment; and 3) a lessening of income inequality as high-income but risk-averse individuals voluntarily exchanged a portion of their expected earnings for a reduction in its variability.

Without such institutional arrangements, real-world incomes will continue to be the product of "some combination of productivity,

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luck, entrepreneurship, and pure, old-fashioned error" (356), just as Horwitz claims. But we need not rejoice in this: "luck" and "pure, old-fashioned error" belong to the explanation of how income is distributed in real-world markets; they do not justify this distribution. If the individual's scope of self-determination is to expand, the reach of luck and error must be diminished.[14] This objective would be well served by institutional arrangements that improve the coordination of individual decisions and extend to workers greater opportunities to reduce the volatility of their income and to insure the value of their human capital. But consideration of such measures requires a willingness to critically judge the performance of real-world markets.

NOTES

1. This reduction in deposits, like the increase in deposits Horwitz seizes upon, is measured relative to the status quo in which the diner continues to purchase his meals at the restaurant.
2. The interest rate may fall because, at a lower level of economic activity, there is a diminished need to hold cash for transactions. But this is a separate point, which, in any case, is not easily accommodated in a theory that takes the interest rate to be a function of the public's willingness to wait.
3. I do not understand Horwitz's claim that this identity holds for nominal income and expenditure, but not for real income and expenditure (363). My copy of 1994 *Economic Report of the President* includes tables displaying the national income accounts in *both* nominal and constant dollars.
4. This assumption is identical to the premise that total output is given, all resources being fully employed, so that an increase in saving has no effect on total income and must, therefore, be offset by an increase in investment.
5. I take as a measure of inequality the income share of the top 5 percent of households (identified by income), a share averaging about 15.5 percent between 1972 and 1974, and about 18.4 percent between 1992 and 1993. The personal saving rate for these periods averaged about 8.6 percent and 5.2 percent, respectively. See Levy 1984 and Mishel and Bernstein 1994. It should also be noted that taxes on saving were reduced significantly during the 1980s.
6. See Gordon, Bowles, and Weisskopf 1990 and Kuttner 1984.
7. *Economic Report of the President*, 1994, 396 and 303.
8. This supposed "inrush of funds into the producer-goods industries" assumes, again, that total output is given, so that when the public increases its saving, total income remains unchanged, and the added savings "rush" into the producer-goods sector.

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9. This is the most likely scenario, but see Chick 1985 for some qualifications.
10. I am here referring to "legal tender" and briefly discuss the endogenous supply of credit below.
11. One cannot, with consistency, accuse Keynes of believing that interest rates "could be continually lowered by increases in the money supply" (361) *and* of believing that interest rates are based on "mere 'conventions'" (362).
12. Whether the increase in investment, income, and saving is a real increase, a nominal increase, or some combination of the two depends on how many, and which, resources in the economy are idle.
13. Horwitz borrows from Henry Hazlitt an example in which a brick is thrown through a shop window, $100 is spent on its repair, and additional income is generated by the multiplier (365). Horwitz says "the fallacy here is the failure to look deeply enough" and, aided by Hazlitt's high-powered microscope, he finds that the shopkeeper would have been better off with his $100 still in pocket and his window unbroken. This is fine as far as it goes, but as an assessment of the overall outcome, the analysis is incomplete. For, if there were idle resources (and the little tale is pointless if there are not), and if the $100 would have remained in the shopkeeper's pocket (the story is equally pointless without this premise), then the action of the multiplier would indeed increase the community's income relative to the status quo.
14. For a theory of justice in which individuals choose their economic fate, see my "Justice and Natural Inequality" (Hill forthcoming).

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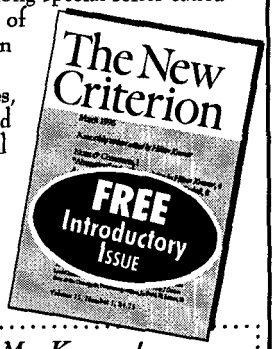

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Warren Breckman and Lars Trägårdh

NATIONALISM, INDIVIDUALISM, AND CAPITALISM: REPLY TO GREENFELD

ABSTRACT: *Reversing the arguments of Anderson, Gellner, and Hobsbawm, Liah Greenfeld contends that it is nationalism that produces economic development. Specifically, she claims that nationalism inspired three seminal economic thinkers: Marx, List, and Smith. However, Greenfeld's ideological preferences lead her to a problematic conception of individualism as nationalism, as well as to flawed treatments of Smith, List, and Marx. Nationalism is better understood as an attempt to address the deepening conflict between the imperative of community and the secular trends of the marketplace, which challenge national sovereignty and democracy.*

The great historical challenge of nationalism has been the construction of the nation-state, driven by the conviction that "the boundaries of governments should coincide in the main with those of nationalities," as John Stuart Mill put it (1975, 298). Despite the extraordinary complexities and, in some cases, the human costs of pursuing this task in practice, the idea of a fit between the nation and the state remains strikingly simple in theory. However, when one moves from the relationship of the political state to the nation, on the one hand, to that of the nation to the economy, on the other, the problems begin to mount. Is it feasible in any way to

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conceive, even in theory, of an alignment between the economy and the nation-state? The hard lesson repeatedly learned by nationalists has been that the economy is synonymous with neither the nation nor the state. Maintaining a recalcitrant autonomy, the market has eluded every attempt to organize it within the bounds of the national polity. While aggressive attempts to achieve the identity of nation and state in the 1990s have drawn much attention, the lack of identity between nation and economy is, arguably, the more universally significant issue. For it is this fraught relationship, in an era dominated by new processes of economic globalization, that increasingly dictates the realities of nationalism and the very possibilities of national sovereignty and democracy.

In light of these considerations, Liah Greenfeld's "The Worth of Nations," recently published in these pages (*Critical Review* 9, no. 4), is a welcome contribution. The author of an ambitious and widely discussed study of nationalism (Greenfeld 1992), Greenfeld attempts in this article to treat in detail the crucial relationship between economics and nationalism through a close analysis of three seminal thinkers: Karl Marx, Friedrich List, and Adam Smith. Arguing forcefully against such writers as Ernest Gellner and Benedict Anderson, who theorize the advent of nationalism as a product of capitalist modernity, Greenfeld sets out to show that it is instead nationalism that produces economic development. She seeks to support this claim by arguing that "nationalism is the inspiration behind the three major trends in popular economic thinking: *Smithianismus*, economic nationalism, and Marxism" (581). The claim to discover nationalism at the root of each of the three figures' economic thinking immediately points to the intended meaning of her title, "The Worth of Nations."

Yet in fact, Greenfeld's reading of each of these prominent thinkers is driven by her attempt to assess the comparative worthiness of nations—or, rather, of nationalisms. Her treatment of Smith is dominated by her valorization of what she considers to be the Anglo-American idea of the nation as a "compact of sovereign individuals." This ideological commitment leads her to a controversial interpretation of Smith as a nationalist thinker. Conversely, Marx and List emerge from Greenfeld's extremely tendentious treatment as originary figures of a very different, anti-individualist nationalism that she associates with a host of crimes ranging from fascism to authoritarianism to racism.

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However flawed we believe Greenfeld's analysis to be, the question that she poses and the intellectual relationships she suggests are so important and potentially fruitful that they warrant careful reconsideration.

Was Marx a Closet Nationalist?

While Greenfeld rejects the temptation to lump all nationalisms into a single category, she appears quite content to divide them into two. Here, we encounter the familiar dichotomization of nationalism into essentially civic and ethnic forms. Greenfeld is equally conventional in associating these forms respectively with the West and the East and in describing German romantic nationalism as the paradigmatic case of anti-Western ethnic nationalism.

Where Greenfeld's article makes its first original, if dubious, contribution is to identify Karl Marx as a typical German romantic nationalist. Greenfeld advances this claim on the basis of a peculiar reading of Marx's important writings of 1843 and 1844. In Greenfeld's view, being a German patriot in the 1840s meant many things, but primarily it involved resentment against the more advanced West and a desire somehow to secure Germany's proper place among nations. Marx's solution, she claims, was to present Germany's apparent inferiority as its advantage; it was Germany's mission to redeem the West by replacing its materialism and "social degeneracy" with the superior cultural values of the "German spirit" (Greenfeld 1995, 561). However, Greenfeld argues, committed though Marx was to this messianic nationalism, its anti-Semitic rhetoric obstructed his full loyalty. Hence, although she concedes the obvious fact that Marx vehemently refused to associate his emerging vision of social revolution either with the project of the nation-state or with any specific national culture, she explains his stark rejection of the nation neither in terms of his response to the social and political situation of Germany and Europe, nor in terms of the ideological radicalization of the Left Hegelians. Rather, she conjures away Marx's opposition to nationalism as a consequence of his psychological need to render palatable his attraction to German nationalism. Thus, Marx took an "ingenious turn of thought" whereby he substituted economic class for nation, thereby remaining faithful to all of German romantic nationalism's "fundamental notions and aspirations, except racism"

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(Greenfeld 1995, 562). That is, Greenfeld continues, Marxian communism is to be understood as a covert form of nationalism universalized as class struggle against a capitalist modernity associated exclusively with the West. From its original expression of German *ressentiment,* Marxism came to serve social patriots of all backward nations "depressed by the spectacle of Western superiority" (ibid.).

Greenfeld finds Marx's nationalist affiliations expressed in the 1844 introduction to his critique of Hegel's *Philosophy of Right,* where Marx contended that German philosophy could play an emancipatory role within European history. However, her attempt to read this as a nationalistic assertion utterly misrepresents the true significance of Marx's universalism and the role of "Germany" within it. His claim for the liberating potential of German philosophy referred almost exclusively to the antireligious humanism of such Left Hegelians as Ludwig Feuerbach and Bruno Bauer; and although Marx regarded radical Left Hegelianism as an outgrowth of the philosophical revolution inaugurated by Kant, nonetheless he was quite ready to criticize the entire German tradition for its idealistic detachment from reality. At most, Marx's argument for the sophistication of Germany's philosophical tradition merely established grounds for assigning Germany a role in modern Europe's revolutionary process. Far from asserting Germany's superiority to the "decadent West"—a notion, incidentally, that did not gain currency until the very end of the nineteenth century and remained alien to Marx's own vocabulary—Marx believed that the emancipatory potential of German philosophy would remain unrealized unless it were allied with the French tradition of revolutionary political activism. This eagerness to integrate the strengths of Germany with those of France highlights the deep ambivalence in Marx's thinking toward the allegedly universal significance of German culture.

Indeed, to the extent that German philosophy held a universal potency for Marx, it lay in its promise to emancipate Germany from itself, that is, from the stagnant, philistine narrowness reviled by him and so many other German radicals of his generation (Breckman, n.d.). That Marx periodically speculated on the possibility that backward social and political milieux such as Germany or Russia might be fertile ground for revolution does not indicate his continuing loyalty to German nationalism. Rather, when he dealt with specific national situations, it was always in order to analyze the prospects of class struggle within specific political contexts.

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The fallacy of associating Marx with nationalism of any sort becomes still clearer if we consider his 1843 essay "On the Jewish Question." Greenfeld, waxing psychological, insists that Marx's approach to this issue was driven by his need to resolve the problem of his own Jewishness in the face of German nationalism, a task that, she argues, took the form of defining this "troublesome ethnicity out of existence"(Greenfeld 1995, 560). It is true that this essay contains obviously troubling comments about Jews, but its significance goes well beyond that; "On the Jewish Question" is first and foremost Marx's seminal redefinition of the terms of human emancipation, as well as the most important analysis he had yet produced concerning the relationship between the modern state and civil society. The point was not to emancipate Germany from its Jews, but to emancipate humanity from the sources of alienation. These sources Marx traced not to the religious tension between Christians and Jews, but to the secular conditions of modern civil society. At this nascent stage of Marx's analysis of capitalism, what struck him was not economic exploitation *per se*, but rather the modern separation of a depoliticized civil society, in which people act as self-interested individuals within the marketplace, from a centralized state that monopolizes the universal interests of the community. Hence, Marx criticized a merely political form of emancipation because it does not reach into the conditions of human life in civil society. He placed his own hopes in a more fundamental act of social, or human, emancipation which would collapse the separation of state from civil society and reunite citizen with bourgeois, political with social, public with private. That is, Marx's conception of human emancipation was oriented toward a humanist universalism that burst the bounds of the state. Attempting to treat this move as anything but a fundamental rejection of the categories of the nation and the state ignores Marx's placement of the project of human emancipation in a newly conceived ideal of a revolutionized, universal civil society.

Far from expressing anti-Western romantic *ressentiment*, Marx's hope for such a universalism was predicated precisely on the dynamism of Western society. Who can read *The German Ideology* or "The Communist Manifesto" without being struck by Marx's awe before the global process of transformation propelled by the Western bourgeoisie? Moreover, who can miss his belief that the expansion of the bourgeois form of production necessarily meant the

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universalization of the working class that Marx believed would be the agent of the coming social revolution? All of this reveals Marx as someone who recognized that the nation-building project was being fatally undermined by the "constantly expanding market [that] chases the bourgeoisie over the whole surface of the globe" (Marx 1978, 476). This insight of Marx's was in fact shared by his contemporary, Friedrich List.

The Empirical Nationalism and Pragmatic Statism of List

List's economic writings are dominated by his acute awareness of the tension between the imperative toward sovereign nationhood and the secular trend toward an international capitalist marketplace. In Greenfeld's interpretation, List resolved this tension fully in favor of the prerogatives of the sovereign nation-state. Thus, she ranges List alongside Marx as a German patriot rankled by the spectacle of West European, that is, British, economic superiority. Where in the one case this presupposition leads Greenfeld to her tortured treatment of Marx's universalism as a veiled form of nationalism, in the other, it steers her into a skewed reading of List's indisputable economic nationalism.

Greenfeld correctly asserts that List's point of departure was his analysis of the uneven economic development of the European nations, specifically Germany's backwardness in contrast to England and France. This led him to champion protective tariffs against imports from those countries, thereby assigning the state a much more prominent role in economic life than would have been tolerated by the classical English political economists. Greenfeld acknowledges the influence of this Listian approach upon economic strategies as widely divergent as the New Deal, the Great Society, Japanese economic planning from the time of the Meiji reforms to the present, and the labor policies described in Robert Reich's *The Work of Nations*. Yet she chooses to conclude her analysis by insinuating an elective affinity between List and fascism. This reduction of List's influence to an insidious violation of liberty is not accidental; rather, it betrays Greenfeld's underlying conviction that "collectivist ideologies are inherently authoritarian" (Greenfeld 1992, 11). Leaving aside for the moment the merits of this assertion about the tendencies of all variants of collectivism, we can ask whether Greenfeld does not grossly misrepresent List's ultimate goals.

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Greenfeld's understanding of List owes a great deal to Roman Szporluk's recent study of List and Marx, in which he depicts nationalism and socialism as the great rival totalizing ideologies of the modern age. While Szporluk regards Marx's founding role in the history of socialism as beyond dispute, his original contribution is to suggest that List provided a theoretical framework linking the economic aspects of the nation's life to its culture and politics, thereby enabling nationalism "to compete successfully with its rivals, including Marxism" (Szporluk 1988, 95).[1] Following Szporluk, Greenfeld argues that List, as opposed to Adam Smith, was "at no point concerned with the prosperity of his fellow men," but that he instead "was devoted singlemindedly to the ideal of a powerful and prestigious Germany" (Greenfeld 1995, 568). This was a devotion, she suggests, that was steeped in a sinister vision of a "state of permanent international competition," itself merely a euphemistic obfuscation of what Carl Schmitt—less prone to "over-fine distinctions"—forthrightly referred to as "war" (ibid., 567).

This claim rests on Szporluk's analysis of List as the nationalist theorist *par excellence*. List's world was, according to Szporluk, "a constellation of large, powerful states engaged in perpetual rivalry that led at times to war, a virtual *bellum omnium contra omnes*." This reading of List is highly questionable. Even Szporluk finds it impossible to ignore that List wrote "eloquently in favor of the alternative vision of a world of peaceful, cooperating nations" (Szporluk 1988, 126). Without offering much beyond mere assertion as evidence, Szporluk dismisses this side of List as not being "his central concern"; it is, however, our contention that the problem is not that List somehow suffered from a case of false consciousness, but that Szporluk's and Greenfeld's eagerness to cast List as the preeminent nationalist leads to a misunderstanding of the place of the nation and the state in his thinking.

To be sure, List sought to correct what he saw as the major flaw in Smithian theory by introducing the notion of "nationality" into his analysis. However, his ultimate vision was neither the war of all against all nor a European or world order under the hegemonic leadership of Germany. Rather, the purpose of the measured protectionism that he proposed was to "make the small and weak [nations] great and strong." Thus, although the "task of national economy was to accomplish the economical development of the nation," List ultimately envisioned the admission of formerly un-

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derdeveloped nations into the "universal society of the future." Far from celebrating a perpetual struggle for supremacy among nations, he espoused "the idea of universal union and an everlasting peace" (List 1922, 126)

List's conception of the nation was not essentialist, but historical, a fact that Szporluk concedes but Greenfeld misses. He rejected any notion of race or immutable national character, holding instead that nations are historically contingent. Surveyed in the topography of intellectual history, List's conception of the nation actually reveals the typical nineteenth-century liberal features identified by Eric Hobsbawm (1990, 14–45). In common with such liberals as Mazzini and Mill, List was much less interested in ethnic homogeneity than in the viability of nations, understood as economies. List adhered to what Hobsbawm has called the "threshold principle," according to which the map of Europe ideally would comprise a small number of ethnically heterogeneous yet economically viable federations. It was precisely such a conception of nationalities as crucial elements within greater federative states that was to enable such later nineteenth-century liberals as Lord Acton to integrate the principle of nationality into a broader defense of liberty (Acton 1995). Overlooking this general context of liberal thought, Szporluk and Greenfeld misname as belligerent imperialism List's insistence on the inevitability that smaller states merge with larger ones; and for the same reason, they dismiss too hastily the sincerity of his commitment to further unification on a Europe-wide and ultimately worldwide basis.

It could be argued further that far from veiling an exclusionist nationalism in the rhetoric of universalism, List authentically stood at the tail end of an older German tradition, one with links both to Kant's vision of a universal civil society and Herder's notion of a community of stateless nations. List's contribution to this tradition lay in joining idealist cosmopolitanism to a hard-headed empirical analysis of modern political economy. Considered in this light, it is clear that List's understanding of the nation was eminently empirical, rather than ideological or romantic. That is, his aim was less to fully actualize the nation in the future than to recognize the reality of nations in the present. Similarly, his statism, which was arguably more crucial to his thought than his purported nationalism, was pragmatic and tactical in nature. Nation-statism was for List not an end in itself, but a means to a greater end.

List was not at all the mortal enemy of free trade and Smithian

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"individualist" economic theory. Instead, he was a friendly critic whose objective was not to destroy the Smithian economic order, but to fully realize it by promoting the ultimate goal of fair and free trade among equals. Thus, List considered protectionism as a limited, staged policy that would be gradually phased out as it accomplished its goals. A

> means of placing those nations which are far behind in civilization on equal terms with the one predominating nation (which, however, never received at the hands of Nature a perpetual right to a monopoly of manufacture, but which merely gained an advance over others in point of time), the system of protection regarded from this point of view appears to be the most efficient means of furthering the final union of nations, and hence also of promoting true freedom of trade. (List 1922, 127)

Moreover, List's provisional statism was not an expression of "authoritarian collectivism," but must be understood alongside his legendary Anglophilism; as Henry William Spiegel has aptly observed, "What List really wanted was to revise creation and turn everyone, as far as possible, into Englishmen" (cited in Szporluk 1988, 123). He enthusiastically endorsed English ideas of freedom and justice, as well as the parliamentary institutions of British government and the rich associational life of the people, reserving his criticism for the way in which British imperial, military, and economic power translated into domination over other nations. To take the most striking instance, this German thinker, a naturalized American citizen who had once aided Andrew Jackson's presidential campaign, objected strenuously to the economic strategy whereby Great Britain attempted to reduce other nations, including the young United States, to purely agricultural production while retaining its monopoly on "manufacture."[2]

Individualism as Nationalism?

If we reconsider Greenfeld's comparison of Marx with List, it is evident that in fact they are alike not in their nationalism, but in their expectation of the eventual disappearance of the state. To be sure, they differed sharply on what that disappearance would entail. Marx was ready to dispense with the state altogether in his anticipation of

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communist revolution, while List imagined a statist phase in the evolution towards universal capitalist society. Whatever the real similarities and differences between Marx and List, Greenfeld insists upon their common commitment to German nationalism. In truth, the only important contrast in Greenfeld's essay is between their shared romantic nationalism and the English nationalism that she claims "suffused Smith's thought" (Greenfeld 1995, 582). We will refrain momentarily from elaborating on the problems of taking a Scot for the consummate Englishman, and instead explore Greenfeld's central argument about the relationship between English nationalism and the British economic miracle of the eighteenth century.

The two boldest claims in her article, indeed, in all of Greenfeld's work on nationalism, are that England was "God's Firstborn," that is, that it was the world's first self-consciously "nationalist" society (Greenfeld 1992), and that "the British economic miracle was just another consequence of English nationalism" (Greenfeld 1995, 579). To take the last claim first, Greenfeld's stunning contention fully inverts the perspective of writers like Gellner, Anderson, and Hobsbawm, who have considered nationalism to be an ideological byproduct of the social and economic modernization process. In attributing British prosperity to English nationalism, Greenfeld dramatically subordinates all other explanations for Britain's rise to economic dominance to the sole agency of the *idea* of the English nation.

By contrast, one of List's fundamental charges against Adam Smith was that his advocacy of cosmopolitan free trade ignored the role of the British state in aiding the country's economic growth in the eighteenth century. Having scaled the peak of prosperity aided by the aggressive activity of the state, List argued, the British had pulled up the ladder by forcing upon the rest of Europe an antistatist free-market ideology. List was not alone in tracing British economic domination to forces other than the blind operation of free competition. Marx made this claim as early as 1845, when he suggested that Britain's preponderance in trade and manufacture was secured through the Navigation Laws, colonial monopolies, protective tariffs, and in the "last resort, wars (especially naval wars)" (Marx 1978, 183). Greenfeld would presumably attribute List's and Marx's analyses to mere *ressentiment*; however, recent work on the rise of the British economy in the eighteenth century supports their basic contention. Thus, John Brewer has written that the late seventeenth and eighteenth centuries witnessed the emergence in

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Britain of a "fiscal-military state" marked by far-flung military commitments, increasing taxation, public deficit finance, and a growing "public administration devoted to organizing the fiscal and military activities of the state. As a result the state cut a substantial figure, becoming the largest single actor in the economy" (Brewer 1989, xvii).

While many economists, including Smith, have argued that the expansion of the British state was economically counterproductive, some economic historians, like Brewer and Nancy Koehn, have argued that an *effective* state, acting in the interests of British military and commercial power and serving to establish a legal and fiscal framework, was important to British economic expansion in the eighteenth century. In this essay, we cannot begin to address the question of whether state activity aided or hindered Britain's long-range macroeconomic development, but insofar as Greenfeld moves from an argument about English perceptions of national identity to one about the causes of the British "economic miracle," it is necessary to consider alternative explanations, including most importantly the relationship between state and economy in eighteenth-century Britain.

Recognizing that the fiscal-military state helped to ensure that international "free competition" would be on British terms does not in itself challenge Greenfeld's contention that English nationalism was the necessary precondition for the economic takeoff. One could, after all, easily imagine an argument that derived state action from perceptions of national interest. Yet the state is entirely absent from Greenfeld's account of England's budding national consciousness, which she identifies solely with the idea of individualism. According to her, the idea of English society as "in essence [an] egalitarian community" of sovereign individuals had already emerged by the early sixteenth century (Greenfeld 1995, 577). This idea had revolutionary effects upon the body politic, she maintains, because the claim that each man is a rational being created in the image of God established the "people, including the lower classes," as "sovereign." Every individual was "equal," "free," "capable of self-government," and, Greenfeld concludes, "therefore capable of participation in the government of their community. The community of such rational, equal, and free men was a nation by definition" (ibid., 577–78).

One meets Greenfeld's confidence about English nationalism

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with considerable skepticism, and not only because of the patently elitist realities of politics in a century dominated by what historians have called "Old Corruption." Faced with her claim for an essentially democratic, individualistic political culture in England as early as the seventeenth century, one wonders how to respond to the Duke of Albemarle's haughty insistence in the 1670s that "the poorer and meaner people" could have "no interest in the commonwealth but the use of breath" (quoted in Colley 1992, 370). A further question is raised by Greenfeld's uncritical association of *English* with *British* "national consciousness" (1995, 577). Whatever the English may have thought about themselves, a *British* sense of identity emerged only slowly in the century after the Act of Union that created Great Britain in 1707. This is not an incidental point, since the "economic miracle" was arguably a British, not a narrowly English, phenomenon. As Linda Colley suggests, British national consciousness did not emerge by way of a "'blending' of the different regional or national cultures contained within its boundaries," nor is its "genesis to be explained primarily in terms of an English 'core'" extended over the peripheral cultures of Scotland and Wales. "Instead," writes Colley, "Britishness was superimposed over an array of internal differences" (1992, 6). This further implies that the intellectual orientation of the Scottish theorists of economic modernity cannot be so easily traced to the ubiquitous influence of English national consciousness. Indeed, recent historiography has highlighted the differences between the Scottish and English Enlightenments and the importance of the Scottish context for Smith's thinking.[3] In any case, Adam Smith was likely more indebted intellectually to French economists like Turgot and Quesnay, whom he encountered during his three years in France, than to any Englishman whom he met during his unhappy student years at Oxford from 1740 to 1746 or his London sojourns in 1766–67 and 1773–77.

Moreover, while a sense of English liberties seems to have been part of English self-understanding, we may again draw on Colley to ask whether British nationalism did not involve more than the individualism hailed by Greenfeld. Great Britain was "an invention forged above all by war," Colley maintains. "Time and time again, war with France brought Britons, whether they hailed from Wales or Scotland or England, into confrontation with an obviously hostile Other and encouraged them to define themselves collectively against it. They defined themselves as Protestants struggling for sur-

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vival against the world's foremost Catholic power" (1992, 5). Briton's self-consciousness as Britons suggests that English individualism may have been but one among several equally potent sources of group identification. This is a conception of national awareness that sits more squarely than Greenfeld's with the real history of eighteenth-century Britain, what with its military-fiscal state and its far-flung military and imperial engagements.

None of these considerations falls within Greenfeld's purview because in the last instance she appears to have little interest in the complexities of English or British history when measured against her endorsement of individualism as the essential core of Anglo-American history and national identity. Given Greenfeld's association of "bad" Eastern nationalism with the state, her account of "good" English nationalism fully subordinates the state to the domain of individuals acting within civil society. Not surprisingly, then, she proceeds to argue that the pursuit of individual wealth was itself an expression of English nationalism: indeed, "to be prosperous and usefully employed became a patriotic duty" (Greenfeld 1995, 580). Hence, she asserts that

> the effect of nationalism on the economy in England was prodigious, for it was the redefinition of the English society as a nation which allowed the economy's emergence from its traditionally subordinate position in relation to political and religious institutions, and its establishment—or institutionalization—at the top of the value hierarchy. (Ibid., 579)

Following this logic, Smith was a genuinely nationalist thinker insofar as he affirmed the *universal* propensity of men to truck and barter. In fact, Greenfeld persists, so pervasive was this national consciousness within Smith's milieu that he unwittingly presented it as the natural, universal form of human social intercourse. Along with Marx and List, Smith is thus revealed to be a nationalist disguised in the mantle of cosmopolitanism; however, Greenfeld clearly believes that Smith's form of nationalism was, unlike those of the Germans, worthy of universalization. After all, she suggests,

> these Englishmen, empowered by their proud nationalism . . . made their economy boom and started the Industrial Revolution; they made their country the envy of the world . . . and they purged filthy lucre of its filth—making it worth striving for for reasons that had

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> nothing to do with greed—by stressing the altruistic element in material self-interest, and elevating the economy to the place of honor it holds in our collective imagination today. (Ibid., 581)

We find at the end of Greenfeld's examination of the "worth of nations," then, a familiar liberal affirmation of the paramount value of individualism both to liberty and economic prosperity. However, whereas individualism is typically contrasted to nationalism, Greenfeld less predictably claims for English individualism a collectivist dimension. It appears that she thereby attempts to preempt an anticipated communitarian critique of this liberal tradition by redefining individualism as itself an adequate source of communal values and collective identity; in short, by making individualism a form of nationalism. Yet this rhetorical move underplays the deep tensions that nationalism has attempted to reconcile: on the one hand, the uneasy relationship between the personal pursuit of profit and the commitment to altruistic ends, between wealth production and the broader needs of community; and on the other hand, the problematic position of the nation-state within a globalizing economy.

Capitalism, Nationalism, and the Conditions of Democracy

Greenfeld's model implies that nationalism was the precondition for modern capitalism; Gellner, Anderson, and Hobsbawm suggest the reverse.[4] However, both of these formulae functionalize the relationship, albeit in opposite directions. We want to suggest that nationalism is better understood as an attempt to address the deepening conflict between the imperative of community and the secular trends of the marketplace. Thus, rather than suggesting a harmonious relationship between community and prosperity, we maintain that nationalism expresses a particularly modern anxiety. This anxiety, moreover, was fully present at the outset of capitalist modernity.

Adam Smith appears relatively sanguine about the compatibility of economic individualism and the public good when compared to many of his thoughtful contemporaries. At least from the time of Mandeville's *Fable of the Bees*, which promised public benefits from private vices, one of the paramount concerns of British political and economic theory was precisely the question of this compatibility. From Viscount Bolingbroke to Smith's friend Adam Ferguson, one

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can trace a strong civic humanist discourse counterposing the values of active public duty to those of self-interested individualism. Moreover, even for a thinker like Smith who was much less prone to moralize against commercial society, the search for adequate sources of social cohesion within a market-driven, individualistic society became increasingly pressing. This provided the basic question of Smith's *The Theory of Moral Sentiments*; and it continued to trouble Smith even as he turned to the economic theory of *The Wealth of Nations*. Alongside Smith's more obvious interest in the laws of wealth production runs a deeply moral concern with the well-being of the body politic that was neither hostile nor reducible to individualism. Smith's orientation toward community is evident in his misgivings about the liquidity of commercial wealth, since "a merchant . . . is not necessarily the citizen of any particular country" (Smith 1993, 116). Furthermore, as Laurence Dickey has written, in contrast to Smith's condemnation of luxury, his valorization of

> frugality and the ethico-political imperative of agricultural investment are where the moral and socio-economic lines of Smith's argument come together. That is, it is where the moral teachings of Berkeley and Hutcheson and the economic teachings of Quesnay and Turgot—the old ethical and the new economic . . . —converge and find their point of balance and mediation. (Dickey 1993, 257–58)

In common with many eighteenth-century British social thinkers, Smith's moral preoccupation was with the internal ethical health of a commercial society. This was a natural perspective for a person standing within the orbit of the world's most powerful economy. For Friedrich List, who shared these concerns about the domestic integrity of the body politic, it was equally natural to focus on the uncertain position of national communities within a global economy dominated by one hegemonic power. Nevertheless, unlike thinkers such as Fichte, who truly sought to shield the national community from these global pressures by advocating a "closed commercial state," List resisted the temptation of autarky. Acknowledging the impossibility of containing economics within strictly national frameworks, he made a concerted effort to address the perceived needs of the community without retreating from the long-term implications of the development of capitalism.

Far from being obsolete at the end of the twentieth century, the

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concerns of both Marx and List are today more relevant than ever. Marx's poignant diagnosis of the expansive dynamic of capitalism may well be his most enduring theoretical legacy. In an age of accelerated transnational capitalism, all traditional bonds truly do seem to melt into air. At the same time, the Listian anticipation of a "universal society of the future" finds current expression in the efforts to build the European Union, a federative order beyond the sovereign nation-state. The economic and political processes currently underway suggest that the nation-state might be a passing configuration that may in the future be surpassed by new forms of political organization more attuned to economic realities. Both List and Marx, in their different ways, foresaw this with remarkable clarity.

Conversely, the harmonious linkage of nationalism with socioeconomic modernity, characteristic of the varying approaches of Greenfeld, Gellner, Hobsbawm, and Anderson, is convincing only so long as we limit our emphasis to the high age of the nation-state. This account of nationalism's relationship to modernity does not fully attend to Marx's prognosis that national sovereignty cannot survive the relentless juggernaut of capitalism. Nationalism's uneasy relationship with economic modernity has become perfectly evident today when all nationalisms have turned from constructive to reactive engagements with the economic process.

However, it is vital to note that the reactive nature of present-day nationalism does not mean that it is inherently reactionary. That is, whereas in some cases we witness a turn toward the utopias of ethnic purity or theocracy, the anxiety of nationalism in the face of economic globalization also poses questions about the future of both community and democracy. The persistent dichotomy between civic and ethnic nationalism obstructs open discussion of the connections among nationalism, democracy, and community. Insofar as commentators like Greenfeld identify desirable civic nationalism solely with abstract individualism, they miss all that is potent in these connections, while they vilify any attempt to assign positive value to a more substantial conception of nationalism's role. It is revealing to note that Greenfeld's typology does allow in theory for the possibility of a collectivist form of civic nationalism. However, in practice, she identifies civic nationalism exclusively with "individualistic libertarian nationalism," set against all collectivist forms of nationalism, which she dubs as explicitly or inherently "authoritarian" (Greenfeld 1992, 11).

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Rather than remain fixed on the divide between ethnic and civic nationalism, a trope that has dominated much of the scholarly discussion since Hans Kohn, we urge the consideration of a distinction within the broad category of civic nationalism itself. That is to say, the collectivist form of civic nationalism, far from being a mere theoretical possibility to be easily dismissed, has historically been the competing democratic alternative to Anglo-American liberalism. Thus, Scandinavian social democracy can be offered as an example of a form of communitarian nationalism that places a high premium on solidarity within the national community, subscribes to a substantive notion of democracy, has a nonethnic and nonracist definition of citizenship, and, with its respect for individual rights and due process, cannot be described in terms of collectivist-authoritarianism. Nor are the Scandinavian countries unique in this respect. Canada has evolved an orientation toward social welfare that is greatly at odds with that of its southern neighbor, a difference in political culture that points to a stronger propensity toward communal solidarity. These are concrete examples of really existing democratic countries informed by an ethos of communitarian nationalism. Characteristic of these countries is a conception of substantive democracy that holds that society can accommodate publicly espoused notions of the good. This contrasts to the ever-increasing privatization of the discussion of the good in American political culture, a phenomenon that has effectively marginalized politics. As Charles Taylor has recently noted, the legislative political process whereby collective social goals are formulated has declined in stature, even as judicial review based on the interpretation of constitutional texts has gained importance (Taylor 1994, 58).

Rather than obsessing about the spectre of ethnic nationalism or subscribing to a highly dubious notion of civic nationalism that reduces it to abstract individualism, ought we not ask whether *any* substantive conception of democracy must rest on some form of communitarian nationalism? It is this question that finally frames the relationship between economics and nationalism. What we are witnessing in the present crisis of the welfare state is not the final triumph of liberalism at the end of history. It is instead a heightened instance of the very tension we have explored in this essay. In ongoing Canadian concerns about NAFTA's impact on national social welfare, or in Scandinavian worries about the effects of EU

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membership on its democratic culture, and, indeed, in American impulses toward protectionism, we may discern anxieties over a deepening threat to the future of democracy. At the very least, we have yet to see whether democracy can follow the market in its trajectory beyond national sovereignty.

NOTES

1. It is worth noting that while Szporluk highlights Marx's hitherto neglected 1845 critique of List, he does not come anywhere close to claiming that List exercised a formative influence upon the young Marx or that they shared German nationalist enthusiasms. Thus, although Szporluk and Greenfeld are clearly in agreement on their interpretation of List as a nationalist, their reading of Marx differs considerably.
2. In addition to his years in America in the 1820s, List also tried his luck in France in the late 1830s. Revealing the cosmopolitan character of his "nationalism," he spent his time writing pamphlets promoting policies to further French economic development. As Szporluk (1988) notes, this was hardly "typical behavior for a German nationalist in the 1830s–1840s, or at any time, for that matter" (113).
3. See the essays of Roy Porter and Norman Phillipson in Porter and Teich 1981 and the essays collected in Hont and Ignatieff 1983.
4. It should be noted that whereas Anderson, Gellner, and Hobsbawm can be grouped together as "modernists" in relation to competing "primordialist" theorists of the nation and nationalism, it is also true that they differ from each other in important respects. Anderson in particular is much closer to our perspective. Thus, he has recently linked nationalism and "exile" in the wider sense of alienation (Anderson 1994), provoked by the disruptions of modern life, a theme already present in *Imagined Communities*, where he traced originary nationalism back to the American Creoles' sense of alienation and exile. While Gellner shows little sympathy for nationalism, and Hobsbawm uses the ironic trope of "invented traditions," Anderson, with his roots in Marxist national liberation ideology, is far more attuned to the specter of alienation and the search for community that he sees as the driving force behind the popular embrace of nationalism.

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Liah Greenfeld

THE BIRTH OF ECONOMIC COMPETITIVENESS: REJOINDER TO BRECKMAN AND TRÄGÅRDH

ABSTRACT: *In "The Worth of Nations" I proposed that nationalism was a major factor in the emergence of the modern, growth-oriented economy. In response to criticisms, I demonstrate here the nationalistic inspiration of seventeenth-century English—or British—economic tracts. Urging a reconsideration of earlier approaches (such as that of W. W. Rostow) to the problem of why—rather than how—the modern economy emerged, I agree with Max Weber's challenge to the naturalness of our proclivity for constant economic expansion, while departing from his explanation for it.*

Professors Breckman and Trägårdh have paid me the compliment of appearing in print with lengthy "reflections" on my essay, "The Worth of Nations," published in a recent issue of *Critical Review* (vol. 9, no. 4). They find flaws in my analysis, but generously remark that "the question that [I pose] and the intellectual relationships [I suggest] are so important and potentially fruitful that they warrant careful reconsideration" (391). I can do no less than respond in kind and give careful consideration to their comments. I regard these as an invitation to a dialogue whose aim can only be to further our understanding of the problem at hand. Accepting this

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invitation offers me an opportunity to clarify and develop some of the ideas I put forward.

It would be both impossible and pointless to address here every question Breckman and Trägårdh raise. Most of their criticisms of my general argument have been anticipated and answered elsewhere, most fully in my 1992 book, *Nationalism: Five Roads to Modernity*. In regard to such criticisms, therefore, I shall limit myself to pointing out where in my publications one may find elucidations of various aspects of my position and refutations of the more unlikely views they attribute to me, devoting to this the introductory part of my essay. I shall spend the rest of the essay dealing with the central problem of the economic implications of nationalism.

Contrary to Breckman's and Trägårdh's assertion (391), I have distinguished three, rather than two, types of nationalism: "individualistic and civic," "collectivistic and civic," and "collectivistic and ethnic." The fundamental distinction, in my view, is between individualistic and collectivistic nationalisms, and not, as they believe, between civic and ethnic; moreover, I strongly disagree with the tendency, to which they claim I subscribe, to invest geography with cultural significance and to equate the ideological and political distinctions between types of nationalism with the categories of "East" and "West."[1] When I laid out the typology in the Introduction to *Nationalism* (Greenfeld 1992), I explained why individualistic nationalism can only be civic, while collectivistic nationalism can take both civic and ethnic forms; I also specified the conditions under which collectivistic nationalism is likely to be civic and those under which it would tend to assume an ethnic character. Breckman and Trägårdh insist that my typology "allow[s only] theoretically for the possibility of a collectivist form of civic nationalism," but that "in practice, [I] identif[y] civic nationalism exclusively with 'individualistic-libertarian nationalism,'" citing page 11 of my book as evidence (404-5). However, I devoted some 50,000 words in that book alone to the detailed explication of civic collectivistic nationalism, choosing French nationalism, the first of this kind, as its paradigmatic example. Unless they somehow missed the entire French chapter (Greenfeld 1992, 89–188) in the book to which they refer in a number of places, I fail to understand the basis of their interpretation of my typology. Insofar as Breckman's and Trägårdh's criticism of my argument is predicated on rejecting the exclusive focus on the civic/ethnic dichotomy, and on the conviction that civic

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collectivistic nationalism is an important phenomenon,[2] they are slamming into open doors. On this point, we seem to be in complete agreement.

Equally puzzling, and of more direct relevance to the question I want to pursue below, is their accusation that "the state is entirely absent from [my] account of England's budding national consciousness, which [I] identify solely with the idea of individualism" (399). To test the validity of this claim, I refer the reader to the chapter on England in *Nationalism* (Greenfeld 1992, 27–88), treating such subjects as the evolution of the modern concept of the "state"; the crucial importance of the Tudor monarchy (i. e., the Tudor "state") in the evolution of English nationalism; the development of a new sense of patriotism, interpreted as commitment to the general good; as well as such aspects of the English national consciousness as, for example, religion, language, literature, and science.

The foundations of Breckman's and Trägårdh's objections to my reading of Marx and List are, on the whole, of a different nature. In these cases, they accuse me of an ideological bias (first attributing to me and then debunking my alleged ideological commitments), which means simply that they perceive my ideological sympathies as tending in an opposite direction from theirs. My *intellectual* position offends their *moral* sensibilities, and, to punish me, they employ various rhetorical devices which, at places, transform a critique of an argument into a personal attack.[3]

To take up the question of the ethics of representing empirical claims (which stand exposed to the possibility of empirical refutation) as ideological fantasies would lead us too far afield. Suffice it to say that, on the purely instrumental level, rhetoric makes a poor substitute for rational argument. If Breckman and Trägårdh doubt the validity of my interpretation of Marxism as inspired by German Romantic nationalism and want to probe it in a serious, that is, rational and empirical, manner, they must begin with the full formulation of this thesis in my 1985 essay, "Nationalism and Class Struggle: Two Forces or One?," and the German chapter of *Nationalism* (Greenfeld 1985, 1992, both referenced in "The Worth of Nations"); and by addressing such pertinent issues, analyzed there, as the centrality within German Romanticism and Romantic nationalism of the ideas of "totality" and "individuality," also central in Marx's thought; the Romantic origins of the concept of alienation;

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the identification, in the thought of political Romantics such as Mueller, of capitalism (interpreted as economic individualism) with the West, namely, England and France, and of communism as the imperative and logical conclusion of the German philosophical tradition, and thus as a national commitment; the close correspondence between the Romantic concept of nation (as developed, for instance, by Fichte) and Marx's concept of class; and the striking parallels between Novalis's "Cristenheit oder Europa" and Marx's "Introduction to the Contribution to the Critique of Hegel's Philosophy of Right." Breckman and Trägårdh also have to give some thought to the development of anti-Semitism as an integral element of German Romantic nationalism, with Jews standing for the resented West; and to the reasons Marx adopted and elaborated on this image in his "Essay on the Jewish Question." (Surely, the cultural context of the "obviously troubling comments about Jews," which Breckman and Trägårdh admit the essay contains, contributes to their significance and makes it somewhat irresponsible to gloss over them in the manner of "boys will be boys.") I should be glad to discuss the matter further after they have done so. Here I want to make only two parenthetical remarks.

First, possibly due to oversight, Breckman and Trägårdh, in their brief exposition of my reading of Marx's 1843 "Introduction," place the phrase "social degeneracy" (of the West) in quotation marks (391), which might lead to the mistaken conclusion that these are my terms. Shortly thereafter, they assert that the notion of the "decadent West" "did not gain currency until the very end of the nineteenth century and remained alien to Marx's own vocabulary" (392). In fact, Marx used the term "degeneracy" to characterize the "modern"—namely French and English, or Western, state—in the 1843 "Introduction"; it occurs in the context of his discussion of the qualifications of German philosophy to accomplish the modern social revolution:

> the modern state, the reality of which remains in the beyond (even if this beyond is only across the Rhine) . . . leaves the *real man* out of account or only satisfies the *whole* man in an illusory way. In politics, the Germans have *thought* what other nations have *done*. Germany has been their *theoretical consciousness*. The abstraction and presumption of its philosophy was in step with the partial and stunted character of their reality. If, therefore, the *status quo* of the German *politi-*

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> *cal system* expresses the *consummation of the ancien regime*, the thorn in the flesh of the modern state, the *status quo* of *German political science* expresses the *imperfection of the modern state* itself, the degeneracy of its flesh. (Marx in Tucker 1978, 59–60)

Second, the very dramatism of Breckman's and Trägårdh's insistence on "Marx's awe before the global process of transformation propelled by the Western bourgeoisie" (393–94)—i. e. globalization driven by modern capitalism—reveals the fallacy of the notion on which they base the main claim of their essay, namely that nationalism should be "understood as an attempt to address the deepening conflict between the imperative of community and the secular trends of the marketplace that challenge national sovereignty" (389, 402). (The circularity of this formulation is almost too obvious for comment: it hardly seems fruitful to interpret something as an attempt to deal with a challenge to itself, and the theory is not improved by the introduction of the mysterious "imperative of community.") The thesis presupposes the newness of the process of economic globalization, the dominance of which today "increasingly dictates the realities of nationalism and the very possibilities of national sovereignty and democracy" (390), presumably limiting them. The market, claim Breckman and Trägårdh, moves on a "trajectory beyond national sovereignty" (406); the national form of political reality, they say, is not "attuned to economic realities" (404). However, Marx's awe of economic globalization in the heyday of European nationalism (1848, it will be remembered, was called "the springtime of the nations") suggests that the aforementioned "secular trends of the marketplace" are neither new, nor particularly relevant to "the realities of nationalism." And if indeed they have challenged national sovereignty from the time when it first became the norm of political organization, their challenge must be deemed remarkably ineffective.[4]

Since in their defense of Friedrich List Breckman and Trägårdh launch an offensive not only against myself, but also against my esteemed colleague, Roman Szporluk, conflating our two very different arguments, a proper response, I believe, would require Professor Szporluk's participation. I don't feel qualified to speak for him. As for my reading of List, Breckman and Trägårdh misunderstand it: unlike Szporluk, I do not at all think List "the preeminent nationalist" (395). They also claim that I was "insinuating an elective affinity

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between List and fascism" (394). This phrasing is an example of my critics' punitive methods of discussion. I was "insinuating" nothing: I asserted the affinity between List's approach to national economy and economic attitudes and policies of fascist states in a manner as direct and clear as possible, and welcomed the reader to consider the validity of this assertion by examining the paradigmatic Italian case (Greenfeld 1995, 569–70). The indiscriminately wide appeal of the "Listian approach" may be lamentable, although I don't see why any moral value should be attached to this fact; but, if it is a fact, to present it as a creation of my ideologically suspect fantasy is not the way to deal with it.

Why Did the Modern Economy Emerge?

I would like to devote the rest of this essay to the most important question Breckman and Trägårdh raise, correctly recognizing it as the central point of my argument in "The Worth of Nations": the role of nationalism in the economic transformation of Britain and then the world. They begin their reflections on it by pointing to the existence of "alternative explanations" (399). Indeed, this transformation—and the British "economic miracle," owing to its pivotal role in the rise of the modern economy, in particular—has long been the focus of research and reflection in both economic history and economic theory, and no one proposing to add to our understanding of the subject can do so without first considering the state of expert opinion on it.

Despite the vast amount of literature devoted to it, the understanding of this fascinating development is as yet incomplete. There are disagreements about its conceptual and historical definition, and this poses a serious impediment to its explanation. While by 1815 the British "takeoff" (to use the now conventional term) is generally believed to have already occurred, there are competing views about a date of far greater importance: when the processes leading to the takeoff began. As often as not (probably, more often than not—proving the validity of Thomas Kuhn's idea of "normal science"), the observer's vision—and therefore the scope of empirical observation—is limited by conjectures based on acquired habits of thought within a professional specialization and, in some cases, tacit ontological assumptions as to the nature of historical processes and

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social reality in general; and the definitions proposed, or implied, reflect this limited vision. Those who see the essence of the process in industrialization, or who view social change as a series of radically discontinuous events, subscribe to a cataclysmic concept of the transformation, defining it literally as the "industrial revolution" and placing it precisely in the four decades between 1775 and 1815. Others, who see history as continuous, or believe that the essence of the modern economic process lies elsewhere, tend to stress the build-up of long-term "preconditions" and "long-distant causes."[5] W. W. Rostow (1975) connects the industrial revolution to "the politics of modernization," commercial revolution, and scientific revolution, affecting all of Europe and North America since the fifteenth century. Alan MacFarlane (1978, 1987), who follows R. H. Tawney in identifying the modern economy with individualism, discerns the origins of British economic breakthrough even farther back in English history; in his view England was certainly individualistic, therefore capitalist, therefore modern, in the thirteenth century, if not before (which takes the edge off the concepts of transformation, revolution, and modernization and, unfortunately, explains away phenomena which these concepts, while admittedly not sufficiently sharp, attempt to pinpoint).

Still, some things are agreed upon. Whenever it began and whatever it was essentially, the transformation of its economy by 1815 propelled Britain, which in 1615 was not perceptibly ahead of other European powers in economic potential and even perceptibly behind some of them, and which, not long before that, could be considered an "economic backwater" (Tawney 1953, 65), to the position of the dominant economic power and kept it there, unrivalled, throughout the nineteenth century. More importantly, this transformation was the first of its kind, breaking through the cycles of growth and decline characteristic of the premodern economy and making growth "a normal condition" (Rostow 1990, 7); it, therefore, signalled the birth of modern economic reality.

Why the modern economy emerged is the central question of both economic history and economics: to answer it is to explain what caused economic growth in the first place and to understand what sustains it in some cases and arrests it in others. Both economic historians and economists, however, have been rather more successful in explaining *how* the modern economy emerged, namely in describing what happened—first in the British economy and

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then in other economies that have accomplished the "takeoff into self-sustained growth"[6]—when the transformation took place. The literature has focused on the conditions and attributes of the economic revolution,[7] not on its causes. The reasons for this focus might have been the centrality of the economic sphere in the modern experience (to which I alluded in "The Worth of Nations") and the paramount—and unquestioned—commitment to economic growth. As David Landes wrote in a recent state-of-the-art review, economists and economic historians from Marx to Simon Kuznets (and increasingly, one may add, the general public around them) considered economic growth to be destiny—natural, inevitable, and self-explanatory. "Because of this, there was no real effort to probe the sources of the wealth of nations. Rather, the process of growth was taken for cause and explanation; the *how* stood in for the *why*." "This confusion of the what and the how for the why, of process and effect for cause" Landes calls "the economists' sympathetic fallacy"—the tendency to substitute "what you know and like for what you need [to know]" (Landes 1991, 4–5, 11).

Caught within a professional paradigm that has been a central element in the worldview of modern society, some students of the economic revolution nevertheless have been aware of the limited nature of their conclusions on the subject. They have generally agreed that the conditions of sustained growth (or the environment in which it happens) include a growing population, the development of financial mechanisms and institutions that encourage capital accumulation, the expansion of markets, and the development of a body of scientific knowledge capable of producing a steady flow of technological inventions. But they have also agreed that, while the obstacles to economic growth posed by the absence of these demographic, financial, commercial, and intellectual factors—a stagnant or declining population, a lack of capital or mechanisms for its transfer, an absence of markets and of technical means of production—are obvious, the nature of their positive effect (i. e., the exact manner in which they stimulate sustained growth where it does not as yet occur) and the fact that they indeed have such a positive effect, or play a causal role, is not as clear. To quote from surveys of the literature in the field, in the British case, population growth "was so closely interwoven with economic expansion that [it is] exceedingly difficult to distinguish cause from effect in the pattern

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of development," while in the developmental cycles of traditional economies, it often formed a Malthusian barrier to economic expansion. Similarly, an increase in the availability of capital "at best . . . is a trend which permits growth to occur. It is not in itself a cause of growth unless it can be argued that a shortage of capital has previously inhibited growth." By the same token, markets have been known to expand in many settings without causing sustained growth, leading to the conclusion that "there is no natural or irresistible movement" from one to the other. And even science and technology, the factors that, to many an economic historian, "distinguishe[d] the world since the industrial revolution from the world before," can only be claimed with certainty to have contributed "to the *progress*" of economic modernization once it has begun; their role in the latter's *origins* are much harder to determine. The level of scientific achievement has not necessarily been reflected in a comparable level of technological invention; invention has not automatically led to innovation; and the wide availability of technology has failed to accomplish economic modernization where it was not taking place for other reasons (Flinn 1967, 36, 54, 77; Perkins 1967, 485; Rostow 1975, 2; Mathias 1979).[8]

The problem identified by Landes—the substitution of descriptive analysis for explanatory theory in the accounts of modern economic growth—finds a clear and very influential exemplar in Rostow's work. Like most economists and economic historians, Rostow assumes the natural and fundamental character of economic processes and, specifically, of the process of growth. Thus, while growth may be impaired by a hostile environment, or promoted by a friendly one, it is, Rostow assumes, inherent in the historical process. Its timing, pace, and especially failure to occur, are thus regarded as problematic and in need of an explanation, but its occurrence in the absence of countervailing factors is seen as self-evident. (For this reason, Rostow [1975] begins his account of the origins of the modern economy with an explanation of why traditional societies did *not* generate self-sustained growth. Putting the question this way is like asking why Shakespeare did not write *Oliver Twist* or Michelangelo did not paint "Guernica.")

Guided by these assumptions, Rostow identifies stages of growth that are analogous to ages of an organism. The "takeoff into self-sustained growth," i. e., the emergence of the modern economy, represents the third stage, and requires "all three of the following

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related conditions: 1) a rise in the rate of productive investment from, say, 5 percent or less to over 10 percent of national income; 2) the development of one or more substantial manufacturing sectors, with a high rate of growth; 3) the existence or quick emergence of a political, social and institutional framework which exploits the impulses to expansion in the modern sector" (Rostow 1990, 39). It should be noted that the first two conditions are conditions *of*, rather than preconditions *for*, takeoff: they describe what happens when takeoff is taking place. The only prerequisite for takeoff, therefore, is the third one, which pertains to the wider social, and especially political, context of the economic process. The addition of the political dimension (which, presumably, includes Breckman and Trägårdh's "relationship between state and economy"[*11]), however, does not add to Rostow's explanation, but raises additional questions about it. If economic growth is natural, then favorable political conditions (specifically, as Rostow specifies elsewhere, nation-states oriented towards economic modernization, i. e. nation-states *interested in takeoff*) merely clear away barriers to takeoff—eliminating obstacles for further development, as revolutions do in the deterministic Marxist scheme. But Rostow is not an explicit, or consistent, determinist. He admits that nation-states have independent agendas and "may be turned in any one of several directions [including] outward to right real or believed past humiliations suffered on the world scene or to exploit real or believed opportunities for national [political] aggrandizement" (Rostow 1990, 29). In short, the alliance of the state and the economy, the *choice* by the state of the path of economic modernization, is not a given; it is not explained when it is postulated or described. The recognition of an exogenous, political factor as a necessary condition for economic growth, therefore, redefines the problem of economic growth. The crucial question becomes *why* certain states develop an *interest* in it. An answer to this question, however, would dictate a project altogether different from the ones attempted in economics and economic history (as well as in most discussions of the relationship between the state and the economy): it would require a study of motivations and would properly belong to the sphere of the history of ideas and the sociology of culture.

Rostow's central metaphor, and, alongside "industrial revolution," the central metaphor of the field—the "takeoff"—also points to the crucial importance of these "ideal factors" which, however, with

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one exception, he accords no more than a passing mention. The metaphor of takeoff suggests an analogy with technology or engineering—"an airplane taking off from the ground" (Flinn 1967, 8)—which, unlike the biological idea of "growth," entails the existence of spirit behind the matter. Airplanes, after all, no matter how perfectly equipped to take off, do not do so of themselves. Nor are they natural phenomena whose development is independent of human will and perceptions. They are constructed for the purpose of carrying out the former and in accordance with the latter, and however complete our understanding of how the airplane is constructed, how it builds up speed and sustains itself in flight, however extensive our knowledge of the physical laws operating at every stage, we cannot understand what caused these laws to operate, why the plane takes off and why it was built in the first place, unless we account for the guiding and creative human intelligence behind the process.

The exception to Rostow's general disregard of directing motives is nationalism. Throughout his work he emphasizes the importance of international competition and "reactive nationalism," that is, nationalism "reacting against intrusion from more advanced nations" in fostering economic growth, and, among other things, proposes that "reactive nationalism . . . has been a most important and powerful motive force in the transition from traditional to modern societies, at least as important as the profit motive" (Rostow 1990, 26). This emphasis is both revealing and problematic. It reflects the salience of nationalism in the economic process, something an empirically sensitive historian cannot avoid noticing, however little it fits into his theoretical scheme. The problem is that nationalism (if only "reactive" nationalism, raising a host of questions about nonreactive nationalism and piquing one's curiosity by its unaccounted-for appearance on the modern economy's runway) does not fit into Rostow's theoretical scheme, but in fact unnecessarily burdens and undermines it.

Reactive nationalism, Rostow observes (after Landes 1969), was especially important in the diffusion of economic growth after the British takeoff, accounting for "a good deal of European economic history in the 19th century" (Rostow 1975, 193). But the logic of his argument dictates that "the preconditions for takeoff were slowly being built up from the 15th to the 18th centuries, from London to St. Petersburg [sic!], from Stockholm to Madrid," mak-

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ing it reasonable to "assume that sooner or later the forces at work would have yielded a takeoff elsewhere in Europe (or in the United States), if Britain had not led the way" (ibid., 222). However, if the process of economic development resulting in the takeoff into sustained growth is endemic—i.e., natural, inherent in history—then the leadership of Britain can have no greater causal significance than the blooming of the first flower on a flowerbed ready to bloom, and the stimulus of reactive nationalism is needless and wholly superfluous in explaining the takeoff of other economies. The prominence of reactive nationalism among the factors responsible for bringing about post-British takeoffs suggests (anomalously for the theory) that the process was contingent on subjective perceptions and interests, again focusing attention on the question of motivation.

The purpose of this discussion is not to criticize Rostow or to diminish the significance of his very valuable contribution to the study of the modern economy. His concept of a "takeoff into self-sustained growth" identified the central characteristic of the modern economy, and his analysis of stages presented a clear and detailed picture of the process of economic modernization, making its features immediately recognizable and helping to prevent its conflation with other, superficially similar, developments. My aim is rather to underscore the inescapable limitations of attempts to explain social (including economic) phenomena while disregarding human agency and the element of motivation. Immediate causes of social action are always the reasons of social actors, and the omission of this crucial link in the chain of social causation keeps even the best, empirically grounded scholarship on the level of description. Rostow's work exemplifies the value and the inadequacy of such scholarship in the same degree, which is especially important to recognize since it has been considered exemplary and has oriented so much subsequent research.[9]

Unlike some of his many followers, Rostow is aware of the built-in limitations of his approach, writing, among other places, in the 1990 edition of *Stages of Growth*, that "the approach to growth via mainstream economics is misleading [because] cultural, social, and political factors are all at work as well as economic factors; and . . . the process of growth is inherently interactive, yielding not only changes in the parameters but even in the rules of behavior. In a sense, there can be no formal theory of growth of the kind held up

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as a goal by Solow until there is a unified theory of both human beings and the societies they construct out of their multi-dimensional complexity" (Rostow 1990, 247). He feels, however, that economists are professionally unprepared to tackle such problems and so must fend as well they can within the bounds of established paradigms.

The Protestant Ethic Controversy

Changes in the rules of economic behavior—specifically, the transformation in the orientations or motivation of economic action, leading to the emergence of the modern economy, capable of sustained growth—have not been entirely disregarded. In fact, they have been the focus of one of the most famous and lasting controversies in the social sciences. I refer, of course, to the debate over Max Weber's *Protestant Ethic and the Spirit of Capitalism*—a deliberate and so far unsurpassed attempt to transcend the limitations of descriptive research exclusively focused on "real factors" and to capture the most elusive aspect in the "multi-dimensional complexity" of economic modernization. Often interpreted as an argument with the ghost of Marx and an idealistic alternative to Marx's materialism, *The Protestant Ethic*, like all of Weber's work, was, rather, a challenge to every kind of deterministic and unilinear theory. The purpose of the essay was to explain the shift in social attitudes toward economic activity, and the nature of new attitudes, which, *in the then-existing conditions of material development* (the state of markets, financial institutions, technology, population, and agricultural capacity) oriented the economy towards, and were responsible for the definition of, growth as socially desirable. New attitudes made growth a value and thereby promoted its institutionalization.

Weber's argument did not by any means imply that these cultural factors produced the capitalist economic system in its entirety or were responsible for any of its elements except one. The scope of the explanation was strictly limited to the motivations that channelled economic action—to the extent allowed by the current development of commerce, finance, and technology—towards *growth*. In the absence of these material conditions, the spirit of capitalism would have no body to animate; it would be economically useless.

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Yet only its presence could communicate to the economy what we recognize as its modern character.

Weber referred to the orientation of the economy towards growth as "the spirit of capitalism" and called the economy oriented to and capable of growth "capitalism." The reason Weber chose this notoriously vague concept might have to do with its prominence in contemporary discussions in which he was participating, specifically its use in Sombart's 1902 *Der Moderne Kapitalismus*, which had already raised the problem of "the spirit of capitalism." It is clear that the term greatly contributed to confusion about Weber's argument and was responsible for some of the reaction against it. But though he might not have been sufficiently sensitive to the symbolic significance the word "capitalism" had acquired or was to acquire in the first decades of the twentieth century, he did make an effort to define the meaning he wished to attribute to it and he offered his readers the means to avoid the kind of misunderstanding that his critics have most commonly exhibited.

In the introduction to his essay, Weber explicitly differentiated *the modern economy*, i.e., the type of *capitalism* he was trying to explain (in the body of the argument he used these two terms interchangeably), from other types of economic and capitalistic activity, and specifically defined his explanandum as an expression of a particular degree and, more importantly, a particular *form* of what he perceived as the fundamental social process and historical principle—"rationalization." Among other things, he wrote:

> The impulse to acquisition, pursuit of gain, of money, of the greatest possible amount of money, has in itself nothing to do with capitalism. . . . One may say that [this impulse] has been common to all sorts and conditions of men at all times and in all countries of the earth, wherever the objective possibility of it is or has been given. . . . Unlimited greed for gain is not in the least identical with capitalism, and still less its spirit. . . . But capitalism is identical with the pursuit of profit, and forever *renewed* profit, by means of continuous, rational, capitalistic enterprise. . . . The important fact is always that a calculation of capital in terms of money is made, whether by modern book-keeping methods or in any other way, however primitive and crude. . . . So far as the transactions are rational, calculation underlies every single action of the partners. . . . But these are points affecting only the *degree* of rationality of capitalistic acquisition. . . . Now in

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this sense capitalism and capitalistic enterprises, even with a considerable rationalization of capitalistic calculation, have existed in all civilized countries of the earth, so far as economic documents permit us to judge—in China, India, Babylon, Egypt, Mediterranean antiquity, and the Middle Ages, as well as in modern times. These were not merely isolated ventures, but economic enterprises which were entirely dependent on the continual renewal of capitalistic undertakings, and even continuous operations. However, trade especially was for a long time not continuous like our own, but consisted essentially in a series of individual undertakings. Only gradually did the activities of even the large merchants acquire an inner cohesion. . . . In any case, the capitalistic enterprise and the capitalistic entrepreneur, not only as occasional but as regular entrepreneurs, are very old and were very widespread.

Now, however, the Occident has developed capitalism both to a quantitative extent, and (carrying this quantitative development) in types, forms, and directions which have never existed elsewhere. . . . In modern times the Occident has developed . . . a very different form of capitalism which has appeared nowhere else: the rational capitalistic organization of (formally) free labor. Only suggestions of it are found elsewhere. . . . The concept of the citizen has not existed outside the Occident, and that of the bourgeoisie outside the modern Occident. Similarly, the proletariat as a class could not exist, because there was no rational organization of free labor under regular discipline. . . . Hence in a universal history of culture the central problem for us is not, in the last analysis, even from a purely economic viewpoint, the development of capitalistic activity as such, differing in different cultures only in form: the adventurer type, or capitalism in trade, war, politics, or administration as sources of gain. It is rather the origin of this sober bourgeois capitalism with its rational organization of free labor. Or in terms of cultural history, the problem is that of the origin of the Western bourgeois class and of its peculiarities. . . . (Weber 1976, 17–24)

Granted the unfortunate choice and somewhat inconsistent use of the term "capitalism" (specifically, its application both to modern and premodern types of economic activity, and to continuously as well as sporadically rational acquisition), it is quite clear what Weber's focus is and what is, consequently, the nature of his question. The modern economy—the "capitalism" of *The Protestant Ethic*—is distinguished by the type and degree of rationalization, and by the institutionalization, or the societal character, of the ac-

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quisitive drive, two separate though related qualities (there is a possibility of rationalization without institutionalization), both of which represent necessary conditions for sustained growth.

"Rationalization" is another problematic concept, also defined only by the many varied contexts in which Weber uses it. "By this term," he writes,

> very different things may be understood. . . . There is, for example, rationalization of mystical contemplation, that is of an attitude which, viewed from other departments of life, is especially irrational, just as much as there are rationalizations of economic life, of technique, of scientific research, of military training, of law and administration. Furthermore, each one of these fields may be rationalized in terms of very different ultimate ends, and what is rational from one point of view may well be irrational from another. Hence rationalizations of the most varied character have existed in various departments of life and in all areas of culture. To characterize their differences from the viewpoint of cultural history it is necessary to know what departments are rationalized and in what direction. (Weber 1976, 26)

The general meaning of "rationalization," which emerges out of and allows its application in such widely differing "departments of life" as mystical contemplation and the economy, is the "articulation and organization, primarily cognitive, of an area of experience." The need for rationalization arises from the inherently disorderly nature of reality to which human beings are born (in distinction from other forms of life, which emerge fully equipped with detailed blueprints for the organization of their environment, in effect carrying order in their genes), and the fact that the responsibility for introducing elements of order into it falls to themselves. "Rationalization," in other words, refers to the fundamental process of the ordering of reality. It is a biological imperative; without it, reality would be unmanageable and the survival of the species impossible. As a result, it goes on all the time, in every society, and in all the spheres of life. In this Weberian framework, to claim that one society is more rational, or "rationalized," than another would be an absurdity; it would be tantamount to claiming that it is more of a society, or more human. "Rationalization" is not necessarily a cumulative process, and the differences between societies (or spheres of activity within a society) in this respect are likely to be not

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quantitative, but qualitative: while they cannot be more or less rationalized, they are, as a rule, rationalized in different ways.

The modern economy, or modern Western capitalism, which Weber sought to explain, was, in his view, a product of "the specific and peculiar rationalism of Western culture" (Weber 1976, 26) which manifested itself, in addition, in Western music, Western architecture, Western science, and Western law. In all these areas, rationalization resulted in the formulation of general principles and types of organization that were endlessly adaptable (or, at least, appeared to be at the beginning of the twentieth century) and capable of endless ramification and therefore internal development. It was this potential for growth (which communicated to these Western cultural phenomena a quality of living entities) that prompted Weber to claim for them a "*universal* significance and value" (Weber 1976, 13).

To conceptualize the central, organizing, historical process as "rationalization" is to recognize it as an essentially mental process. "Rationalization" goes on in the minds of individuals, and in the overwhelming majority of cases, the significance of particular rationalizations is strictly limited. Some rationalizations, however—those that organize recurrent experiences shared by members of numerically or otherwise influential groups—acquire the character of a social process: their articulation becomes a matter of collective effort, with benefits extending far beyond the circle of those who actively participate in it. When the reality that is being rationalized endures over time, rationalization may become the basis of institutionalization. In this case the society commits itself to a particular rationalization—i. e., a particular way of organizing a certain area of experience, a particular image of order—and, putting its weight behind it, makes subscription to it normative, incorporating it as, and into, the social structure. It is through such incorporation into social institutions that rationalization (in its diverse forms) exerts its most profound and lasting influence and acts as the organizing force in society. When Weber speaks of the "specific and peculiar rationalism of Western culture," whether in music, science, law, or economy, he is referring precisely to such a social force.

For all the attempts to represent him as an idealist, Weber is not in fact interested in disembodied ideas or in "rationalization" as such, but in the socially significant, that is, institutionalized, rationalization that transcends its original individual character and ac-

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quires a societal one. Consequently, the problem he poses in *The Protestant Ethic* and other works (often only suggesting a solution) is necessarily twofold: one must explain (a) the evolution of a particular form of rationalization and (b) its institutionalization, which does not follow automatically.

In light of the specific definition of Weber's explanandum—(the spirit of) capitalism—as both a form of rationalization potentially conducive to growth, and a societal (rather than individual) phenomenon that allows for the realization of this potential, many of the criticisms levelled against his thesis lose their relevance. To claim that certain individuals among late medieval Catholics possessed the capitalist spirit as defined by Weber is in no way to undermine his thesis (as Sombart 1915 or Fanfani 1955 would have it, for instance), because what is in question is not the dispositions of individuals, but a cultural—that is, societal—propensity. And to reject Weber's definition of the capitalist spirit, as does, for example, Robertson 1933, on the grounds that it disregards men's natural "appetite for riches" and would astonish "a realist like Marx, who originated the discussions on capitalism" (which, presumably, gives him a prior claim on how it should be defined) is, obviously, to engage in an altogether different discourse.

Most of Weber's critics, whether or not they understood the nature of his question, focused on the central empirical proposition of *The Protestant Ethic*, which related the emergence of new norms of economic behavior, constituting "the spirit of capitalism," to Protestantism, specifically to Calvinism's dogma of predestination and its interpretation of the idea of the "calling." Weber's proposition was based on the observation, not seriously disputed in his time or later (however tentative the agreement on its significance), that economic action was visibly reoriented in Northern Europe, specifically in England, somewhere around the seventeenth century. As a result of this change, the accumulation of profit (thus growth), which for centuries had been condemned as leading to perdition and thus was pursued only erratically, came to be practiced systematically and with a confidence that bespoke not just toleration, but encouragement by the society at large. To prompt the positive reinterpretation of the pursuit of profit (and its institutionalization), a congenial cultural environment, a new moral code, had to emerge in the immediately preceding period. Since that happened to be the period of religious revolution which affected all of Western Eu-

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rope, but specifically North European societies, the explanation naturally suggested itself.

This sensible hypothesis has not been corroborated by subsequent research. It has been repeatedly pointed out that Weber's interpretation of the Protestant ethic, which was to explain the spirit of capitalism, was based on the very documents that formed the basis of his idea of that spirit. Moreover, a systematic examination of the writings of the leading early Protestant divines revealed them to be economic traditionalists, as suspicious of enterprise and hostile to profit-making (and, therefore, growth) as any medieval Schoolman, if not more so, and so most unlikely godparents of economic progress (Tawney 1953; Hyma 1955). This examination, bringing into sharper focus such Protestant theological principles as the ideas of predestination and "calling," also cast serious doubt on Weber's interpretation of these principles. At the very least, as Tawney was to conclude, Weber had attributed to them greater significance and consistency than the sources warranted. Weber's almost exclusive concentration on Puritan England as an example of the religious origins of the spirit of capitalism, and especially his inattention to the equally Calvinist Netherlands, whose economic prowess was not sustained and, at its zenith, was apparently infused with a somewhat different spirit (see Hamilton 1995, 4, 11), further weakened the argument.

A refutation of Weber's hypothesis regarding the relationship of Calvinist Protestantism and the spirit of capitalism, however, was nothing Weber would not expect. For while he proposed that the ethic of the modern economy (i.e., the orientations and norms of behavior that imply and encourage growth) was related to this particular religio-ethical system, he also suggested that this system could have a functional equivalent. This suggestion made explicit the tentative, provisional, *hypothetical* character of the central empirical thesis of *The Protestant Ethic*, entirely consistent with Weber's *Wissenschaftslehre*—specifically, with his conviction that the price of scientific progress and improved understanding was the continuous supersession of older hypotheses by new and more accurate ones.

Moreover, to prove Weber wrong about Protestantism was to disprove a relatively minor point of his theory, the essence of which consisted in the claim that the emergence of the modern economy could not have occurred without a new set of motivations and a new system of ethics. This theory presupposed a recognition of so-

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ciety as an aspect of life of a thinking species endowed with prodigious symbolic capacity but insufficient genetic regulation, and thus distinguished by the propensity and the need for rationalization. The distinctive characteristic of (human) social action, which made it essentially unlike the behavior of other species, even those capable of highly sophisticated cooperative action, was its meaningfully intentional character. But for meaningful and intentional social action to be consistently channelled in a particular direction, it had to be invested with a positive meaning: it had to be an object of social approbation; it had to be defined as legitimate and morally commendable. In other words, it had to find support in a system of ethics. An enduring reorientation in a particular type of social action (for instance, economic action) implied the development of new motivations and intentions among the participants, which presupposed an emergence of new ethical standards. Proving that the cultural environment of capitalism was not a product of the Protestant Reformation did not negate this general and far more important theory, and contributed little to the solution of the problem with which it was concerned—the reorientation of social action and the emergence of the modern economy. To focus on whether or not Weber was right in claiming this dramatic role for a particular religious teaching would be to beg the question. Yet this is exactly what most of Weber's critics did.

The fruitlessness of the debate over (or, rather, preoccupation with) *The Protestant Ethic*, which by now has lasted almost a century, should, no doubt, be attributed to the fact that Weber's opponents considered the refutation of a relatively minor point to be an end in itself. They failed to appreciate the broader sociological significance of Weber's essay. This failure is most conspicuous where it is of greatest consequence, in the writings of economic historians,[10] and, among them, in R. H. Tawney's influential and in many respects impressive *Religion and the Rise of Capitalism*.

The very title of Tawney's book reflected his misunderstanding of Weber. The focus on religion was misplaced: as Tawney convincingly demonstrated, on closer examination Protestantism turned out to be an unlikely doctrine to promote the *ethos* of the modern economic system, which Weber called the spirit of capitalism; and nobody ever suspected of such sympathies its major religious alternative. One had to look for the source of this ethical reorientation in a wider cultural context. Instead of undertaking this search,

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however, Tawney redefined the spirit of capitalism itself, equating it with "conscienceless individualism," and thereby identifying capitalism with the egoistic pursuit of one's material self-interest, uninhibited by moral scruples or social concerns.

That individualism is identical with the spirit, or, as it has been lately referred to, the "culture" of capitalism—which, in turn, stands for the modern or even the industrialized economy—is a common assumption, lying at the basis of much contemporary economic history. It is but a reformulation of the fundamental proposition of mainstream *laissez-faire* economics, to the effect that economic growth is a function of greed or a natural acquisitive impulse—the very notion which, Weber suggested, should be extinguished in the kindergarten (Weber 1976, 17). Its roots, like the roots of *laissez-faire* economics, go back to the vulgarization of Smith's idea of the "invisible hand," which substituted, for his complex view of man as the bearer of moral sentiments, the surreal but simple image of the self-interested, rational egoist, representing the embodiment of the propensity "to truck, barter, and exchange." The misunderstanding of Weber thus is directly linked to the misunderstanding of Smith.

Having redefined his explanandum, Tawney resolved the problem of the inconsistency between the ethical principles of Protestantism and the values of the modern economy, retaining the explanans. The question was no longer that of the emergence of a new system of social norms and ethical standards, a *cultural* system of "peculiarly Occidental rationalism," actively orienting social action. Instead, the issue was the relaxation of previously existing ethical standards that had restrained the emergence of a self-directed (and inherently rational) *natural* economic system. The specific character of the ethical standards that were relaxed was of no importance. What mattered was the fact of relaxation and, perhaps, the process that brought it about. Protestantism, Tawney claimed, did indeed play a role in the emergence of the new "commercial civilization," but it played this role despite what it represented and because of what happened *to* it. Its economic function was due primarily not to the nature of the faith, as Weber had suggested, but to exogenous circumstances that led to the loss of faith and resulted in "the abdication of religion from its theoretical primacy over economic activity and social institutions" (Tawney 1953, 76). "The elements which combined to produce [the modern] economic revolution," Tawney wrote, "are too numerous to be summarized in any neat formula.

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But, side by side with expansion of trade and the rise of the new classes to political power, there was a further cause. . . . It was the contraction of the territory within which the writ of religion was conceived to run" (Tawney 1953, 228).

Tawney, therefore, professed partial agreement with Weber's thesis, conceding that "Puritanism [was] a potent force in preparing the way for the commercial civilization which finally triumphed after the Revolution." In effect, however, he substituted for Weber's theory an entirely different argument that can in all fairness be characterized as a reversion to orthodox Marxism. He concluded that Calvinism, and in particular English Puritanism, eventually grew less disapproving of the pursuit of profit, more tolerant towards economic motives, less restricting in respect to enterprise, and thus able to regard business life in general with greater equanimity than it had been originally (and than were other currents within Christianity). It thus released "the magnificent energy which changed in a century the face of material civilization" and made possible economic progress. But, he claimed, such friendliness to economic development on the part of Puritanism was itself the effect of this development's "corroding march" on it. "The 'capitalist spirit,'" Tawney wrote,

> is as old as history, and was not, as has sometimes been said, the offspring of Puritanism. . . . At first sight, no contrast could be more violent than that between the iron collectivism, . . . the remorseless and violent vigours practiced in Calvin's Geneva and preached elsewhere . . . by his disciples, and the impatient rejection of all traditional restrictions on economic enterprise which was the temper of the English business world after the Civil War. . . . Like traits of individual character which are suppressed till the approach of maturity releases them, the tendencies of Puritanism, which were to make it later a potent ally of the movement against the control of economic relations in the name either of social morality or of public interest, did not reveal themselves till political and economic changes had prepared a congenial environment for their growth. . . . In the late 16th and early 17th centuries, had come the wave of commercial expansion—companies, colonies, capitalism in textiles, capitalism in mining, capitalism in finance—on the crest of which the English commercial classes, in Calvin's day still held in leading-strings by conservative statesmen, had climbed to a position of dignity and affluence. . . . The collectivist, half-communistic aspect [of Puritanism]

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> which had never been acclimatized in England, quietly dropped out of notice. . . . Individualism congenial to the world of business became the distinctive characteristic of Puritanism which had arrived, and which, in becoming a political force, was at once secularized and committed to a career of compromise. . . . Given the social and political conditions in England, the transformation was inevitable. (Tawney 1953, 192–93; 207; 182; 188–95).

The "wave of commercial expansion," the "commercial classes" (whose rise Weber considered *the* problem of the cultural history of economics), the "world of business," apparently, appeared of themselves or were, like the spirit of capitalism, as old as history, and therefore did not require an explanation. This argument essentially reversed Weber's thesis regarding the relationship between economic development and religion. To Tawney, it was economics that gave rise to "the Protestant ethic," picking out and cultivating one of several currents in the doctrine, and selecting, or, in effect, constructing, an appropriate ideology for economic development.

The role that Protestantism was *forced* to play, according to Tawney, consisted in leaving economics alone, letting individualism take the place of the collective consciousness, and thereby "liberating economic energies" (Tawney 1953, 98) or allowing free play to Adam Smith's (misunderstood) invisible hand. Ideological controls were lifted, all shackles removed, and man could pursue his rational interest. The rest was natural, automatic, self-evident. The argument made sense only on the assumption of the rationality of the pursuit of material self-interest, namely gain, and of the resulting economic process, thus of their natural character. When man's nature is defined as rational, rationality, by definition, becomes the essential expression of nature—the equivalent of an instinct. The trouble with this assumption is not just that it reduces humanity to the level of genetically programmed dumb beasts and eliminates with one fell swoop the grand problem of order and the need for the social sciences, but that the modern economic process and the behavior that lies at its basis are neither natural nor rational in this sense. Both Weber and Troeltsch recognized and stressed this repeatedly. As Weber wrote explicitly in his definition of the spirit of capitalism,

> In fact, the *summum bonum* of [the capitalist economic] ethic, the earning of more and more money, combined with the strict avoidance of all spontaneous enjoyment of life, is completely devoid of

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> any eudaemonistic, not to say hedonistic, admixture. It is thought of so purely as an end in itself, that from the point of view of the happiness of, or utility to, the single individual, it appears entirely transcendental and absolutely irrational. . . . Economic acquisition is no longer subordinated to man as the means for the satisfaction of his material needs. This reversal of what we should call the natural relationship, so irrational from a naive point of view, is evidently as definitively a leading principle of capitalism as it is foreign to all peoples not under capitalistic influence. (Weber 1976, 53)

If the spirit of capitalism is not, in itself, natural and rational, yet is, obviously, regarded as such, it must at some point have been *defined* (or interpreted) as natural and rational, making it imperative for us to approach the emergence of the modern economy as a problem in the cultural construction of reality. If, on the other hand, one assumes that the orientation of modern capitalism—to profit-making and thus to growth—is natural in the sense of being objectively rational and fundamental, one has to account for the recency and the unevenness of its institutionalization, and for the fact that for millennia it was allowed only sporadic manifestations. To attribute this to artificially imposed ethical (ideological) restraints would not suffice, for the two indisputably fundamental orientations of human nature, the hunger and sex drives, though always ideologically regulated and often "repressed," have, after all, never been reduced to the level of deviant behavior—for centuries the status of profit-oriented economic activity—but, on the contrary, have always been provided with institutionalized channels for systematic expression and gratification. Every society invests food and sex with some degree of cultural significance and makes them an object of moral, ethical, interpretation. Even the alimentary and sexual experiences are, therefore, to a degree, culturally constructed. But their genetic determination assures their fundamental moral indifference, in the sense that, on the level of whole societies, these drives neither can be effectively suppressed, nor, more importantly, require cultural, ethical stimulation for their sustained and robust manifestation. For this very reason these fundamental natural drives are not historical phenomena; like animal societies, they have no history. History, including economic history, exists precisely because social (and economic) reality is genetically indeterminate, not "natural" in this weighty sense of the word.

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We return to the fundamental thesis of Weber's sociology. History is the march (or, rather, ramble) of rationalization, the endless succession of disconnected attempts to introduce order into experience which does not carry it within itself. The process of rationalization is natural, as is humanity. But man-made things are, by definition, artificial, and so are the products of rationalization, those specific orientations of social action, interpretations, ideals, and images, those various "rationalisms," peculiar to one or another culture, that Weber tried to delineate, if not to explain. There is nothing inevitable about them, they do not occur of themselves, they are not self-evident. It is the unnaturalness, irrationality—and historicity—of the "peculiarly Occidental rationalism" that makes it impossible to grasp fully the dynamics of the modern economic process without understanding its cultural origins, and this requires that we locate some ethical system that transformed an erratic individual propensity into a social ideal to be systematically pursued. And if Puritanism, Protestantism, and religion in general prove not to be that ethical system, we have to cast our net wider.

I have spent this much time on "the Weber thesis" because my argument about nationalism and the modern economy derives directly from the premises of *The Protestant Ethic*, and I want to make clear both where I agree with it and where I dissent and go my own way. In my disagreement with Weber, as much as in my agreement, I believe I follow the principles of his approach. Credit should be given where it is due. Though the meagerness of returns upon a most considerable expenditure of effort on the part of the social sciences reveals that, unlike either the natural sciences or the modern economy, they have not yet reached the stage of the takeoff into self-sustained growth, Newton's metaphor concerning scientific progress applies to social scientists too. If ever we see farther than our predecessors, it is only because we stand on the shoulders of giants.

Nationalism and the Modern Economy

And now—*revenons à nos moutons*. The question I posed in the essay to which Breckman and Trägårdh are responding may bear repeating. It is a question of motivation and it falls within the domain of the sociology of knowledge. I am asking why the historically ex-

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ceptional inclination for ever-increasing gain, once regarded at best with suspicion, became defined, on the level of the individual, as rational self-interest, constitutive of man's very nature; and, on the level of society, as equivalent to the common good, the paramount collective interest. I claim that behind this shift of societal attitudes toward the acquisitive drive stood a new, secular, form of collective consciousness (thus a new system of ethical standards)—nationalism. This makes nationalism the source of "the spirit of capitalism"—the orientation of modern economic action—and a crucial factor in the emergence of the modern economy. But my thesis does not entail that nationalism was "the sole agency" in this process.[11] No account of *why* something happens is complete unless supplemented by the account of *how* it happens; it is one thing to explain why economic growth became a desired goal, quite another to elucidate the conditions and mechanisms that have allowed for its realization. I deal only with desire and leave the question of capability to economists and economic historians. They have been sharpening the tools of their analysis for a century and delved so deep into the minutiae of economic development as to make scrutiny of their findings by an amateur a hopeless and needless project. I do not doubt the soundness of their conclusions—insofar as they do not confuse (to quote Landes again) the process with its cause, the what and the how with the why. On my part, I do not presume to provide a comprehensive, or an "alternative," explanation of the rise of the modern economy of growth, but merely to add to the existing explanation a missing—and essential—motivational dimension.

The relationship between desire and capability, as Weber argued in regard to the capitalist spirit and capitalist forms of organization, is not one of necessary or simple interdependence. The two, he wrote, "may very well occur separately." Today, in particular, examples abound of an ardent desire for economic growth even when no conditions exist for its realization, and even today there are cases (which one may assume to be more common in earlier periods) when an enormous potential for growth remains unrealized because there is not enough desire for it, as in Russia. The relationship, Weber suggests, is best conceptualized as that of mutual reinforcement between essentially autonomous factors, with the attitude of mind finding its most suitable expression when the capability exists, and the capability deriving its most suitable motive force from the attitude of mind

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(Weber 1976, 64–65). Both, therefore, should be taken into consideration in explaining the modern economy.

Quite aside from its ubiquitous presence in the age of economic growth, several factors recommend nationalism to the attention of a student of the modern economy. To start, it has the merit of fitting in perfectly in terms of the chronology of "the industrial revolution" broadly defined and, in particular, allows us to account for the dazzling—and otherwise perplexing—case of Britain. It should be remembered that the historical priority of Britain's takeoff does not make sense in the framework of the "natural evolution" theory in economics and economic history. On the threshold of its economic supremacy Britain was hardly the most advanced economy in the world. From the standpoint of the objective preconditions for takeoff, as late as the sixteenth century, the Dutch Republic, France, Germany, and arguably even Spain and Italy were better positioned to assume the role that fell to Britain. It was exactly because Britain came from behind, and overtook, these more advanced economies, that its rise was of the nature of a miracle. The fact that relatively backward England, and not the equally Calvinist Dutch Republic, accomplished the breakthrough and achieved lasting dominance in the modern economic system is a major anomaly for the "Protestant ethic" thesis as well. Bringing nationalism into the argument, however, resolves these anomalies.

Nationalism first appeared in England, becoming the preponderant vision of society there and effectively transforming social consciousness by 1600. More than a century had to pass before signs of similar transformations were felt elsewhere. In the Netherlands, in particular, perhaps because the society was so advanced, economically as well as politically, the development of national identity and consciousness were delayed still further and cannot be discerned until well into the nineteenth century. England, therefore, was the first to acquire a new spirit, it was the only one to possess it for some two centuries, and this spirit, this motive force, added to its relatively unimpressive resources an element that reoriented, transformed, and magnified them, inspiring it to undertake a journey for which other societies might have been better equipped, and thus giving it a competitive edge over them.

Unlike Protestantism, nationalism necessarily promotes the type of social structure which the modern economy needs to develop. Being inherently egalitarian, nationalism has as one of its central

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cultural consequences an open—or class—system of stratification, which allows for social mobility, frees labor to shift between sectors, and dramatically expands the sphere for the operation of market forces. Since it redefines the nature of social hierarchy, in the absence of countervailing factors it elevates the prestige of traditionally disparaged occupations, specifically those oriented to the pursuit of profit, and makes them a magnet for talent—the function Weber attributed to the Calvinist dogma of predestination and the idea of a calling. Also, because of its members' investment in the dignity—that is, the prestige—of the nation, which is necessarily assessed in relation to the status of other nations, nationalism implies international competition. It makes international competitiveness a measure of success in every sphere a nation defines as significant for its self-image, and commits societies that define themselves as nations to a race with a relative, and therefore, forever receding finish line. When the economy is included among the areas of competition, this race presupposes a commitment to constant growth. In other words, the sustained growth characteristic of the modern economy is not self-sustaining, but is stimulated and sustained by nationalism.

While it is conducive to the development of a social structure of the type that a modern economy requires and while it stimulates international competition, nationalism actively promotes economic growth only when economic achievement, competitiveness, and prosperity are defined as positive and important national values. This, in turn, depends on the specific character of a particular nationalism. As a rule, individualistic and civic nationalisms, which define nations as associations of individuals, value economic achievement simply because of its significance for large numbers of individuals, and include economic growth among national interests for the same reason. Collectivistic nationalisms (either civic or ethnic), however, define national interests independently of the interests of individuals and may not include among them economic interests at all, or may consider them of secondary importance. In ethnic nationalisms where economic activity is not particularly valued, it is often ethnic minorities who become prominent economic actors, and this may stigmatize both the minorities and the economic activity. For that reason, it is likely that, in ethnic nations, economic activity, and growth, will be more valued when these nations are ethnically homogeneous.

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The initial predisposition of individualistic and civic English nationalism toward economic activity and achievement was reinforced by certain idiosyncratic features that favored the economy (alongside science)[12] as a particular area of national superiority. English nationalism thus directly and actively promoted economic growth. The spectacular economic success of Britain and its rise to superpower status were major stimulants of economic competitiveness, ensuring that many anti-British, reactive nationalisms also focused on economics, and greatly contributing to the formation of modern "economic civilization."

The ability of *English* nationalism to contribute to the *British*, and then worldwide, "economic miracle"[13] is explained, in the first place, by the fact that the British (as later the American) "sense of identity" evolved from the conceptual framework, and on the basis of principles, provided by the original English nationalism;[14] and, secondly, by the contagious nature (for the entire world) of the British example. What is of utmost importance here is that this effect of nationalism was not simply an effect of a cultural factor, but was, ultimately, a cultural effect. This owed not to the fact that nationalism *liberated* natural economic energies from the constraining tutelage of ethical considerations and social concerns, but, on the contrary, to the fact that it provided a new set of ethical considerations and social concerns. These concerns invested economic growth with a positive value, focusing naturally diffuse social energies on it.

Nationalism is a form of social consciousness, a way of cognitively and morally organizing reality.[15] As such it represents the foundation of the *moral* order of modern society, the source of its values, the framework of its characteristic identity, and the basis of social integration within it. The fact that the original nationalism, to which we owe the forward aspiration of the modern economy and its insatiable yearning for ever greater material power, was (and to a large extent is, both at the place of its birth and where it was transplanted—for instance, in the United States and Australia) a form of philosophical and moral individualism in no respect contradicts, and should not obscure, its social function. As a principle of social solidarity individualistic nationalism has proved to be very effective, perhaps more effective than nationalism of collectivistic types, if the exceptional political stability of individualistic nations (underneath the constant ripple of conflict) and the unusually low

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rate of emigration from them (despite the lack of legal impediments) are indications. This is not surprising if individualism is understood, as in this case it must be, as a moral ideal that directs and controls natural appetites, rather than as a form of moral laxity that allows them free rein. The definition of the individual as the highest *social* value and the fundamental moral unit of society—i.e. as an independent moral actor—adds dignity to the national identity and, taking much farther the commitment to egalitarianism preached by all nationalisms, makes its practice in individualistic nationalisms much more consistent than in nationalisms of other types, thereby increasing the national commitment.

Individualism (as a moral and philosophical position) and nationalism (as a form of social consciousness and collective solidarity) may be perceived as contradictory only if the moral primacy of the individual is believed also to be an empirical or natural primacy—that is, if the original, or natural, individual is believed to be presocial (a notion, curiously, that is met only in individualistic societies). While perfectly consistent with the anthropological and sociological presuppositions of contemporary economic theory (which also flourishes mainly in individualistic nations), this belief runs counter to all we know of the life of other sociable species, knowledge that economist-philosophers, given their naturalistic bent, might be expected to take into consideration. A natural individual organism is not an individual in the sense we ascribe to the term: an independent moral agent. Such individuality is a product of culture, not of nature; it is necessarily an aspiration, a projection of an ideal image that nature can only approximate, and thus of an image of society—of *social* consciousness, of a particular type of rationalization. Already Durkheim recognized the individual as a social construction, specifically a product of organic solidarity. He thought individualism was the way modern society "represented" itself in the minds of its members and made them worship it and obey its commands. It was, for him, the central element of the moral and cognitive complex he called "*conscience collective*," the core of a directing, compelling ethic of the kind Weber thought he found in Protestantism.

This individualist *ethic* is the distinguishing characteristic of that communal identity, that type of nationalism, which provided the original inspiration for the economics of sustained growth. But while, as I argued in "The Worth of Nations," modern economic theory presupposed the principles of this type of nationalism and

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would be inconceivable if it were not individualistic, modern economic practice drew inspiration from nationalism as such. England developed economic nationalism because its national consciousness was individualistic. But, as demonstrated *inter alia* by the protracted debate around the ideas of free trade and economic freedom more generally, and the slowness with which private and public interest came to be associated as a matter of course, early economic nationalism in England was focused exclusively on the common good of the nation, to which the good of its individual members was held, as for Friedrich List two centuries later, to be subservient.

Nationalist Origins of the Modern Economic Orientation

Economic nationalism emerged in England alongside nationalism in general: it was, to begin with, a refraction of national consciousness in the consciousness of the economically active strata. It would be wrong to say that members of these strata perceived nationalism as instrumental to their (economic) interests. Rather, superadded onto their occupational and estate identities, national identity changed the nature of these other identities, altering the meaning—and potential importance—of belonging to these strata (that is, transforming "class" consciousness and the very nature of the "trading" or "commercial class"), and thus implying the formation of new interests which were perceived at once as the interests of these economically active strata and as national interests.

There are clear signs of a reorientation in the attitudes of economic actors in England and the emergence among them of a new—competitive, assertive, and nationalistic—spirit very early in the sixteenth century. Foreign trade provides the most dramatic example of this. At the time English foreign trade was dominated by merchants of the Hanseatic League. The Hanseatics were granted special privileges by English kings, who, from Richard II to Henry VIII, turned to them in their hour of financial need. Their "Kontor" in London occupied the Steelyard, the place of the London standard weighing-balance, and their centrality in the English economy was reflected in the (perhaps apocryphal) belief that even the English currency, "pound sterling," derived from their nickname—"Easterlings." The privileges of the Hanseatics in England were a reflection of their wealth and their capacity to finance the English

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Crown, but this capacity was sustained by their privileges, which perpetuated their superiority over the native merchants. While these privileges lasted, no group of English merchants could compete or hope to compete with the League, but the privileges would not be revoked unless a community of interest was perceived to exist between the struggling English merchants and the Crown. Such a community of interest was perceived by both the merchants and the Crown as soon as England was defined as a nation (and, while it might incorrectly be supposed that such a perception was objectively in the interest of the merchants, it was clearly not in the interest of the Crown).

In 1505, Henry VII granted an extensive charter of privileges to a fellowship of cloth merchants with chapters in several English port cities, incorporating them as the Company of Merchants Adventurers. The fellowship, which had existed since the thirteenth century as a loose organization, similar in principle to the Hanseatic League and Dutch trading companies, became the first national (in the sense of being "centralized" in fact as well as in principle) trading company, and from 1564 it called itself the "Merchants Adventurers of England." Like the Hanseatic League and other organizations of the time, the Merchants Adventurers sought to monopolize the trade in which they were engaged and saw nothing wrong with measures that would facilitate their commerce and inhibit that of their competitors; but, unlike other trading companies, who were satisfied with procuring privileges from rulers of the countries in which they traded, the Merchants Adventurers tried to secure primarily the support of "their own," i. e., English, rulers. In addition, they accepted only native-born Englishmen and insisted that they marry Englishwomen.

The commercial policies of the English state, at least until the reign of Elizabeth, were not consistent. Henry VII favored the English merchants over their foreign competitors in general, and imposed a heavy penalty on the Hanseatic merchants for selling cloth in the traditional market of the Merchants Adventurers. Henry VIII, plagued by financial problems, was less committed to the English merchants, and may, on balance, have helped the Hanse to strengthen its presence in England. By that time, however, the Merchants Adventurers already exported twice as much cloth (which was the main English manufacture—"the credite and Creame of the Kingdome")[16] as the League. English nationalists were not sat-

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isfied; they exaggerated the share of the Hanseatics and underrepresented that of the English merchants. Under Edward, they set out to terminate the Hanseatic privileges.

The initiative came from Sir Thomas Gresham, the founder, for "the publique good oth'Nation,"[17] of both the Exchange and the College that cradled English science. As the financial agent of Edward VI in Antwerp, Gresham was entrusted with liquidating considerable debts left there by Henry VIII and was determined to do so without further loans from foreigners. If the Merchants Adventurers, already a formidable economic organization, were relieved of competition from the Hanseatic League, they could be relied on for the necessary funds. In 1552, a court of the King's Privy Council revoked the special privileges of the merchants of the Hanse, putting them under the heavy duties imposed on all other foreign merchants. The export trade of the Merchants Adventurers increased dramatically as a result, but whether the members of the fellowship felt much improvement in their individual situations is questionable, for much of the Company's profits from that point on went to financing the state. The arrangement was clearly in the interest of Gresham, who was a nationalist, but, unless the Merchants Adventurers, as well as the Crown, also identified their interests with the interest (in this case, the financial independence and dignity) of the nation, it could be argued that they acted against their interests.

Some of the privileges of the Hanse were reinstated under Mary. But the accession of Elizabeth signalled the beginning of their end and of the no-longer-interrupted economic ascendancy of England. Gresham was the queen's financial advisor, and the advice he profferred (which she, we are told, followed unswervingly) contained such points as "not to restore Steelyard [the Hanse] to their usurped privileges; to come in as small debt as you can beyond seas; to keep up your credit, and especially with your own merchants, for it is they must stand by you at all events in your necessity."[18] Here we have a stark example of nationalism being made an explicit foundation of the economic policy of the state, and of a nationalist educating—and guiding—the state.

By 1558, the Merchants Adventurers dominated the cloth export trade. When the revolt of the Netherlands destabilized their traditional market, they invaded the traditional market of the Hanseatics. The reason they were able to do so was that, unlike themselves, the

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league of the Hanse towns was indeed instrumental only, and faced with an opportunity to advance one's particular interests at the expense of the other member cities, none of them, unless pressured, thought twice. In 1564, the Merchants Adventurers of England, flaunting their identity, were allowed to trade in Hamburg, which, four years later, against the opposition of the League, offered them a ten-year contract of privileges as extensive as those previously held by the Hanseatic merchants in England. Somewhat later, counting on the invincibility of the Spanish Armada and the restoration of the status quo ante, Hamburg withdrew its welcome and an imperial mandate was drafted with the purpose of exiling the Merchants Adventurers from the territory of the Empire as a monopoly. It was not made effective for 15 years, however, during which time the Hanse repeatedly and unsuccessfully attempted to force Elizabeth into reinstating them in their privileges and the Merchants Adventurers continued to operate in German markets. The decree was finally issued in 1597. In response, Elizabeth exiled all Hanseatic merchants from England, leaving English merchants in control of the lucrative English cloth export-trade.

This was a victory for the nationalist principle in commerce. Both the queen and the Merchants Adventurers agreed that it was in the interest of the nation. But it was not in the "objective" economic interest of the English state or people, including the individual members of the Merchants Adventurers. In the words of G. B. Hotchkiss, who studied the commercial warfare between the Merchants Adventurers and the Hanseatics,

> The interruption of trade with Germany obviously could not prove a benefit to English industry . . . It aggravated the depression from which the business of the country was already suffering as a result of the long war with Spain. Not only was the Spanish market cut off, but the Mediterranean trade-routes were still dangerous for English shipping. Capital had been withdrawn from legitimate trade to be invested in privateering expeditions, gold-seeking explorations, and other speculative enterprises. . . . It may truly be argued that this bold and brilliant period of English history not only produced great heroes and great literature, but incubated great schemes that were later to enrich the nation. Out of it came the great East India Company . . . and the companies formed to colonize America. But these enterprises brought no dividends for a long time to come. . . . [These] were lean years for most of the people who lived through

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> them. Prices were high and many workers were unemployed. The triumph of the principle of English trade by Englishmen was a fine thing for English patriotism, but it brought no immediate gains to English purses. (Hotchkiss 1931, 46–47)

What reaction this sacrifice of their purses for the sake of a patriotic ideal aroused among the general public may be gleaned from a play, "Englishmen for My Money, or A Woman Will Have Her Will," written by William Haughton and produced by Henslowe in 1598. It poked fun at foreign merchants—a Frenchman, an Italian, and a Dutchman (i. e., a German),[19] especially the latter—and clearly celebrated the (Pyrrhic) victory of the English over the Hanseatics. The foreign merchants vainly attempted to win the hearts of three English sisters, and were supported in their efforts by the girls' father, an English merchant, but of Portuguese birth; the girls themselves, however, all native-born English maidens, preferred Englishmen as suitors. (Among other things, the play suggested that it did not take long at the time to become English, demonstrating that English nationalism, even when accentuated for dramatic effect, lacked an ethnic dimension; belonging was not to be understood in terms of blood.)

The Birth of Political Economy

If there was an adverse reaction to the material plight in which their new ideal commitments placed the English, it expressed itself in the sentiment against monopolies and regulated companies and for free trade in England, i. e., for the liberty of all Englishmen to trade. It was this sentiment that, apparently, induced the Secretary of the Merchants Adventurers, John Wheeler, to issue an apology for the company, *A Treatise of Commerce,* in 1601. The book was "the first example of commercial publicity on behalf of a private profit-making organization" (Hotchkiss 1931, 11), and one of the earliest, if not the earliest, English defenses of commerce in general, justifying economic activity in terms of prevailing ethical ideals, articulating its relationship to these ideals, and presenting it as inherently just. Because of its early date and the significance of its subject, *A Treatise of Commerce* is a document that deserves a most careful

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study. It is made all the more remarkable by the paucity of references to religion, let alone expressions of religious sentiment.

The moral ideal to which Wheeler relates commerce, and the sentiment to which he appeals exclusively, are the national ideal and sentiment. The merits of commerce in general, and in particular of the way it is carried on by the Company of Merchants Adventurers, lie in the "benefits and commodities arising" therefrom to the English "State and Commonwealth." The preference for regulation over free trade is justified by "*Experience*[—]the surest Doctor in the School of Man's life," which teaches that regulation does greater good to the commonwealth of England, while free (or, rather, "dispersed, straggling, and promiscuous") trade at best benefits a few "private English" who, in their disorganized ways, make "vile the principallest commodity of the Realm," i. e. cloth, "embasing that excellent Commodity [to] the discredit of our Nation." Rather than being "private gain and lucre seekers" (which, Wheeler thinks, the Company "by no sound reason or argument can be charged to be"), the Merchants Adventurers are "moved in duty toward her Majesty and their Native Country" (Wheeler 1931 facsimile text, 119–305; edited text, 307–460, 340, 373, 371, 375, 374, 428, 366).[20] The organization of the Company, specifically, has the purpose of

> the seemly and orderly Government and rule of all the members, parts, and brethren of the said Company wheresoever in their trade and feat of Merchandise. Secondly the Preservation of Amity, and the Intercourse between the Realm of England and their Neighbours and Allies, and the Preventing of Innovations, griefs, wrongs, and exactions contrary to the same. Thirdly, the great Vent, Advancement, and keeping in Estimation of English Commodities, and the bringing in of foreign Commodities good cheap. Fourthly, the Maintenance of Navigation. Fifthly, the Increase of Queen's Incomes and Customs. Sixthly, and lastly, the Honor and Service of the Prince and of our State and Country, at home and abroad. (Wheeler 1931, 340)

It should be noted that in this list political and prestige-related benefits take precedence over the strictly economic. The last chapter of the book, building Wheeler's *apologia* to a climax and making explicit his clinching argument—which was introduced, however, very early in the text and which runs through it—stresses the contribution of commerce and the Merchants Adventurers, in particu-

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lar, to the honor, or prestige, of England. The merchants represent the Nation in foreign lands. They serve, literally and metaphorically, as its ambassadors. If they look good, it looks good. A large, regulated company, representing England officially as indicated by its very title, "Merchants Adventurers of England," obviously makes a greater impression than a "straggling" private Englishman here and there. The concluding chapter contains a detailed description of the care taken by the Adventurers to show off "at the change of Princes and receiving in of new, at triumphs for victories and coronations [, proving that] the said Company have not forgot the honour of their Prince and Country, but have spent and laid out great sums of money this way." The display at the entry of Philip of Spain to Antwerp in 1549, for instance, had cost them above two thousand French crowns, with the Governor of the Company and thirty merchants riding in a livery of purple velvet, "and paned hose embroidered full of silver waves like the waves of the sea," with doublets of satin and hats with fair brooches, "and each of them a chain of gold about his neck of great value," and more and more, including three score and six beautifully clad lackeys and three pages on horseback. "In which their doing they showed themselves for the honour of their Prince and Country nothing inferior to the merchants of other nations, namely the Germans, Easterlings, Italians, Spaniards and Portugals, and surmounting some of them in costly apparel, furniture of themselves and their horses, and in other preparation to entertain the said Prince, whereby they won great honour and commendation to themselves and the whole English name" (Wheeler 1931, 438–39).

As commendation of the Merchants Adventurers brought honor to the English nation, so too any injury to them was an insult to England. Since Elizabeth fully concurred in this perception, Wheeler was able to represent the rivalry between his company and the Hanseatic League, to the history of which he devoted about a third of his *Treatise*, as a "controversy between her Majesty and the Hanses," a political conflict between two nations, England and Germany (even though the latter at the time was truly an "imagined community"—in the sense that it existed solely in the imagination of the English). Hanseatic merchants were portrayed as England's ill-wishers and as "favourers" of the preeminent national enemy, Spain. In their efforts to undercut the trade of the Merchants Adventurers, the Germans knowingly assisted in the Spanish plot "to

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set strangers over us, and to reestablish Popery, and so lastly, bring the whole English people and subjects of her Majesty into miserable slavery of body and conscience, under an ungodly and superstitious Nation, from which the Almighty God in mercy keep us and our posterity." (The extremity of the civic peril in this case, apparently, justified the very unusual, for Wheeler, concentration of religious references and a most exceptional appeal to the Almighty God.) "The Hanses," Wheeler tells us, after all "were sore insensed, not only against the said M.M. Adventurers, but also against the whole English name." The end of the imperial Mandate, for which they were responsible, "a blind man may see to be none other than through the sides of the M.M. Adventurers to hurt and wound the State of England," and the intention behind the mandate's publication 15 years later was to cause "greater and more enormous injury and reproach of her Majesty and her Highness' actions and of the Company of M.M. Adventurers, as no doubt their meaning was, that were the authors and doers thereof, and consequently to make the whole English nation and name the more odious and condemned by all men" (ibid., 425, 360–61, 366, 368, 403).

The expulsion of the Hanseatic merchants from the English export trade was therefore a triumph for the English nation, and whatever inconveniences resulted from the loss of extensive imperial markets in consequence had to be borne cheerfully by "all the well-willers and lovers of the Commonwealth and State of England and all the good subjects of her Majesty . . . lest unawares they join[ed] hands with the common enemy" (Wheeler 1931, 368). Happily, such patriotic exertion was required only briefly. Before long Hanseatic towns, Stade in 1607, Hamburg in 1611, animated by commercial good sense rather than considerations of communal dignity, broke ranks and opened the German market to the Merchants Adventurers. It thus became "the dominant commercial organization in the world" and "the most famous company of merchants in Christendom" (Hotchkiss, 1931, 8),[21] the title it was to hold onto until "the lusty English giant,"[22] the East India Company, in a way the Merchants Adventurers' own progeny, rose to claim it.

An important aspect of Wheeler's *Treatise of Commerce* was the defense of commerce in general, to which he devoted the first chapter of the book. Here he introduced some important ideas that were to become commonplace in economics and Western thought

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in general, but were clearly radical in his time. For example, he was of the opinion that "there is nothing in the world so ordinary and natural unto men, as to contract, truck, merchandize, and traffic with one another," a thought that his more famous compatriot was to repeat almost verbatim and make proverbial in 1776. The definition of the propensity to "truck, barter, and exchange" as natural, however, did not in itself lead to its commendation; for instance, it led Catholic Schoolmen, as Tawney demonstrated so convincingly, to condemn it. Wheeler, however, went farther. He defined commerce very widely, including in it "all that a man worketh with his hand or discourseth in his spirit" and all manner of exchange, whether of goods or services, oriented to a material end, even "selling words." His meaning was similar to what we would, probably, call the "economic system," and it, he claimed, was the foundation of civic life, on a par with government. To this effect Wheeler quoted a Latin maxim, one of many that were interspersed in the *Treatise* and that, whether this was his intention or not, contributed to the impression that the author was a learned, sophisticated man, which could only serve to elevate the "estate of Merchandise" he represented in the eyes of the readers among whom the several thousand copies of the book were distributed. To elevate this estate, consisting of people engaged in economic activity, was indeed Wheeler's express goal. The economic propensity, he wrote, was universal, found in "both high and low, yet there are of the notablest and pricipallest traffickers which are ashamed and think scorn to be called Merchants." This, he believed, was an unacceptable attitude, for

> indeed merchandise which is used by way of proper vocation, being rightly considered of, is not to be despised, or accounted base by men of judgment, but to the contrary by many reasons and examples it is to be proved that the estate is honorable, and may be exercised not only of those of the third estate (as we term them) but also by the Nobles and chiefest men of this Realm with commendable profit, and without any derogation to their Nobilities, high degrees, and conditions. With what great good to their States, honor, and enriching of themselves and their Countries, the *Venetians*, *Florentines*, *Genoese*, and our neighbours the *Hollanders*, have used this trade of life, who knoweth not? Or having seen the beauty, strength, opulency, and populousness of the abovesaid Cities and Provinces wondereth not thereat? (Wheeler 1931, 316–17)

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In his introduction to the modern edition of the *Treatise*, Hotchkiss commented that while Wheeler's defense of the commercial estate "suggests that in his time a defense was needed, its tone is not humble" (Hotchkiss 1931, 71). Indeed it was a reflection of the new national consciousness, which attached little importance to the distinctions between nobles and commoners and presupposed a fluid and open, that is, egalitarian, conception of social stratification. Wheeler was the first to spell out and draw attention to the implications of this egalitarian national principle for the status of the trading classes. Not everyone was equally perceptive, and this might have been the reason for the efforts of the numerous defenders of the dignity of commerce in the next two centuries. Their "apologies," however, were even less humble than his and with time grew openly boastful. Their tone, in fact, suggests that, in these later cases, the defense was often undertaken not because it was needed, but because it was sheer fun.

Wheeler's *Treatise of Commerce* started the public discourse on economic matters in England. Its publication in effect marked the beginning of that tradition of business literature and political economy, which, by imperceptible stages, was to transform our idea of economic activity from something that needed justification in terms of extraneous values to something that was the foundation of all values. In the Stationers' Register for 1600 "the only title that seems to suggest business is Shakespeare's *The Merchant of Venice*." "Books dealing in any way with business [before 1601] had been few and far between; most of these few were dramas or other forms of entertainment, or else criticisms by clergymen and landowners" (Hotchkiss 1931, 101). Like the first swallow announcing the coming of spring, Wheeler's *Treatise* signalled the arrival of a new mindset, and soon similar books came pouring in.[23]

Moved, like Thomas Mun (or Munn)—a merchant of the East India Company and the author of the very influential *England's Treasure by Forraign Trade*—by the "Zeal to the Common-wealth,"[24] one concerned writer after another exhorted business-minded Englishmen to exert themselves for the benefit of their nation. They strove to teach their readers "how to love and serve [their] country, by instructing [them] in the duties and proceedings of sundry [economic] Vocations," and in the process developed "doctrines which have subsequently been labeled mercantilist" (Mun 1986, iv; Supple 1964, 188). They all discussed economic issues in

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the light of the good that might come from them to England, and so presented economic power (or wealth) as a very important tool, but a tool nevertheless, for the achievement of the ultimate goals of national prestige and political and military might.[25]

Some of this literature consisted of apologia—advertisements—for private corporations, written by members whose aim was to garner public support for a particular business or way of doing business. A considerable portion, however, was written by authors who were men of affairs only occasionally and could be regarded as disinterested propagandists, moved solely by altruistic, nationalist concerns (though, obviously, they identified the interest of the nation with their own). Among such authors was Sir Walter Raleigh, who, in 1605, "provoked [by] my love and bounden duty to your Majesty and my country," came out with "Observations touching Trade and Commerce with the Hollander, and other Nations . . . wherein is proved That our Sea and Land Commodities serve to inrich and strengthen other Countries against our own" (Raleigh 1859, 1–28). Raleigh's attitude was different from Wheeler's. Raleigh sought not to guarantee merely the dignity and independence of English trade (to which he added manufacture) as such, but to ensure English preeminence over all others. He was openly jealous of foreign merchants, the Dutch in particular, and saw them as England's economic rivals and competitors, even though these foreign merchants did not impinge on the *existing interests* of English merchant companies and were not in direct competition with them; Raleigh simply envied their success. Here was the national competitive spirit (which animated and fortified the Merchants Adventurers in their conflict with the Hanse) in the abstract, which made it a far more powerful motive and vastly increased the scope of its application.

Raleigh was offended by the fact that, though England was far better situated and endowed for the role of the world's greatest commercial power, this position belonged to enterprising little Holland, which had no such advantages. Holland's greatness was an injury to English prosperity and honor, and this made Holland England's enemy, in thought as well as in deed. The language Raleigh used to describe the effects of Dutch trade on England left no room for any other interpretation. "They suck our commonwealth of her riches," he wrote, "cut down our merchants, and decay our navigation; not with their natural commodities, which

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grow in their own countries, but the merchandises of other countries and kingdoms . . . they beat us out of trade in all parts with our own commodities." England was partly to blame for this, however. It was a shame to the nation, he admonished King James, leading "to the great decay of your kingdom, and impoverishing of your people, discredit to the company of merchants, and dishonor to the land, that any nation that have no corn in their own country growing, should serve this famous kingdom, which God hath so enabled within itself. . . . That any nation should carry away out of this kingdom yearly great mass of money for fish taken in our seas and sold again by them to us . . . must needs be a great dishonor to our nation, and hindrance to the realm." And yet, he insisted, "all [they do] we may do better than they," and would do, if only the king introduced the right policies. "They outgo us in all kind of fishing and merchandising in all countries, by reason they spare no cost, nor deny no privileges that may encourage advancement of trade and manufactory." England needed to follow this example; it had to turn the stream of trade "to the good of this kingdom" (Raleigh 1859, 9, 15, 10, 13, 16, 13), which would "prevent the deceivers, ingross the commodities of the ingrossers,[26] inrich ourselves, and increase our navigation, shipping, and mariners, [and thereby] make all nations to vail the bonnet to England." To these ends, among other things (such as the encouragement of shipbuilding and fishing, the cultivation of manufacture, and the protection of trade), Raleigh advised the King "to allure and encourage the people for their private gain, to be all workers and creators of a commonwealth" (Raleigh 1859, 26, 27). This was undoubtedly a proposition validating material self-interest, but it was clearly advocated only as a means to a higher, collective end.

Economic Competitiveness and National Greatness

The competitive economic consciousness matured quickly. In the course of its development, new elements were added to its early articulations, while others grew more robust and assertive. In the "Chaos and old Night" of the Civil War, ostensibly animated by the spirit of religion, the new secular spirit crystallized, its premises grew explicit and distinct, and its nature became unmistakeable. Nationalism was this new spirit, the cognitive and ethical frame-

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work that gave meaning to reality, and it was no longer conceivable that economic matters, among others, could be evaluated and made meaningful in any but its terms. In 1663 Samuel Fortrey perceived "the genius, and disposition of the times, to study more the Interest and Improvement of the nation, then usually heretofore," and offered to the reader a work that faithfully reflected this preoccupation of the age in its title as well as contents. *Englands Interest and Improvement,* thought Fortrey's contemporary Josiah Child, was "a most rational and admirable Treatise" and "hath done more for [the] Country than would have been the Gift of some millions of pounds sterling, into the Publique Exchequer." It was, apparently, quite influential, directly affecting commercial policies and specifically inspiring the protective anti-French legislation of 1678–88 (Hollander 1907, 3).

Fortrey opened the treatise with a new and radical claim, that "Englands Interest and Improvement consists chiefly in the increase of store and trade." Economic strength and prosperity were not simply aids to, but foundations of national greatness. Two things were "chiefly necessary to make a nation great, and powerfull; which is to be rich and populous." Since, in respect to these two things, England "not onely equal[ed] any neighbour countrey, but far excel[led them] in all profitable advantages," it could "expect to become the most great, and flourishing [nation] of all others" (Fortrey 1907, 11–12). To realize this natural potential, Fortrey recommended the adoption of a liberal immigration policy; cut-throat competition, supported by protectionist measures, with neighbor nations that might harbor similar aspirations; and the subordination of private to public interest under all circumstances.

England would do well, he wrote, to give permission "to all people of foreign contreys . . . freely to inhabit and reside within this kingdom with liberty to buy or sell lands or goods, to import or export any commodities, with the like privilege that *English* men have, [for] it might very much increase, both the riches and power of this nation." Specifically, "by this liberty to foreiners," he thought, "we should quickly attain to the perfection of those manufactures, which now we so highly value and purchase so dear from abroad." Fortrey was confident that for their part, foreigners would want to become Englishmen, because England was naturally "as pleasant, or more pleasant, healthful, fruitful and temperate than any other" country; it was, as a political community, "far better than any

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other, for the ease, quiet, peace and security of the people"; and it had a superior economic potential that, if realized so that "our trade and manufactures were but improved to that advantage, as they are capable of, there would be no country in the world, where industrious people might improve their estates, and grow more rich, than in this." The hope of gain, he thought, was a natural proclivity and bore "so great a sway amongst men, that it [was] alone sufficient to prevail with most" (Fortrey 1907, 13, 18–9, 13–4).

England had yet another advantage, which, if the first three were not sufficient, would make its appeal irresistible: it was "the most eminent and intire countrey of all others, that profess the Protestant Religion." The Protestant religion was preferable because it was "free from vain and superstitious beliefs and ceremonies [and] the onely model of true piety and vertue," but its chief recommendation consisted in that to profess it, to the exclusion of other creeds, was for England "a matter of greatest policy and prudence." The alternative (besides return to vain and superstitious Catholicism, which was not to be considered) was internal division and strife—all too real a possibility in 1663, the thought of which indeed led some to wonder whether "a strict uniformity in Church-government" was not the only means to prevent it from materializing. Fortrey conceded that the thought was valid, but stipulated that, were such uniformity made a policy, care should be taken "that what is so imposed, be onely such things as are barely necessary and such as may agree best with the quiet and preservation of the State" (Fortrey 1907, 14–15, 17). In this philosophical and frankly utilitarian approach to religion, nonchalantly expressed virtually on the morrow of the Puritan Rebellion, there is no reflection of the soul-scorching sacred fires, kindled by the dread of eternal damnation, which alone could empower Protestantism to beget the spirit of capitalism. Far from serving as the validating moral standard for secular behavior, religion is itself validated by its contribution and correspondence to an emphatically secular end: the interest of the nation.

This interest, the nation's greatness, according to Fortrey, was directly dependent not simply on England's economic strength and prosperity, but on its economic supremacy (we would call it competitiveness) relative to other nations. In fact, such relative supremacy was the measure of prosperity. The context of Fortrey's argument was essentially comparative, and not for a moment, while

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he discoursed on England's interest and improvement, did he lose sight of the relevant others. His readiness to embrace "all foreigners" who would become Englishmen and his complete indifference to the ethnic origins of his compatriots—an indifference that has been an integral part of English national consciousness—coexisted with anxious and aggressive suspicion of all foreigners still united in their separate political communities, which characterized English national consciousness in this early period.

The guiding principles of Fortrey's economic theory were few: "The art is when we deal with strangers, to sell dear and to buy cheap; and this will increase our wealth"; and to take care "that we impoverish not our selves to enrich strangers"—the danger of which, apparently, far surpassed that of impoverishing ourselves with no benefit to outsiders. All other economic policies and ideas were assessed in the light of these axioms and subject to change in accordance with circumstances. To gain the upper hand over foreigners, Fortrey advocated growing cattle at the expense of wheat and the selective, pragmatic use of both free trade and protective tariffs. He wrote:

> Our care should . . . be, to increase chiefly those things which are of least charge at home, and greatest value abroad; and cattel may be of far greater advantage to us, then corn can be . . . for what we should increase in the room of it of greater value by exportation, would not onely bring us home as much corn as that land would have yeelded, but plenty of money to boot. . . . We may also by our singular advantage, in the increase of those cattel, have the sole trade, being able so far to exceed our own wants, as to furnish all our neighbours, who must be forced [N.B.] to good rates. . . . And might we freely have the liberty to export them, or so much of them as may be fitting, we should need no laws to hinder the exportation of corn. . . . Concerning our trade abroad . . . when any commodity is raised to the greatest height it is capable of, it should be free for exportation, under so reasonable customs, that the merchant may afford his commodities abroad, as cheap as others, or else he would not be able to vent it. . . . All foreign commodities whatsoever, that are onely usefull to be spent within the nation [and thus cannot contribute to its economic improvement and competitiveness], and that have already all their perfection, as fruits, sugars, wines, linen cloth, laces, silks . . . such commodities should pay extraordinary customs. . . . (Fortrey 1907, 19–20, 28)

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This neighborly philosophy in principle applied to all countries with which England maintained trade relations, but the significant other for Fortrey was France. France was the chief supplier of luxury commodities, such as silks, laces, and wines, for which the English, to Fortrey's chagrin, had developed an "unnatural" taste and on which they were wasting "at least sixteen hundred thousands pounds a year." He could not think without consternation about "the vast sums of money the *French* yearly delude us of; either by such commodities as we may as well have of our own, or else by such others, as we might well in great part be without." And he exhorted Charles II, freshly restored to the English throne, to quit aping French fashions and set a better example to his people.

> Hereby it may appear how insensibly our treasure will be exhausted, and the nation begger'd, whilst we carelessly neglect our own Interest, and strangers abroad are diligent to make their advantages by us. But most of these evils would be easily prevented, if onely his Majesty would be pleased to commend to his people, by his own example, the esteem and value he hath of his own commodities, in which the greatest Courtier may be as honourably clad, as in the best dress, *Paris*, or a *French* Taylour can put him in; besides it seems to be more honourable for a King of *England*, rather to become a pattern to his own people, than to conform to the humours and fancies of other nations. . . . (Fortrey 1907, 26, 24, 26)

Fortrey advocated state intervention in economic affairs in general. "Private advantages," he wrote, "are often impediments of publick profit; . . . whereby it may appear, how necessary it is that the publick profits should be in a single power to direct, whose Interest is onely the benefit of the whole." The interests of individuals were to be subordinated to the interest of the nation, which was not necessarily the same. For example, enclosures were in the interest of the nation, but individuals, misguided by "the many several Interests," could not agree that it would result in the "properest use, and best advantage" of the land, and in consequence of this selfish blindness, "much land [was] tilled . . . to the increase of nothing but beggery in this nation." Fortrey dismissed arguments that enclosures led to depopulation:

> as to depopulations by inclosures, granting it increases plenty . . . how increase and plenty can depopulate, cannot well be conceived;

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> nor surely do any imagine that the people which lived in those towns they call depopulated, were all destroyed, because they lived no longer there; when indeed they were onely removed to other places, where they might better benefit themselves, and profit the publick. . . . And if the manufactures and other profitable employments of this nation are increased, by adding thereto such numbers of people, who formerly served onely to waste, not to increase the store of the nation, it cannot be denied, but the encouragement of inclosure, where every mans just right may be preserved, would infinitely conduce to the increase and plenty of this nation. . . . (Fortrey 1907, 13, 21, 23)

He argued similarly in defense of the recent Acts of Navigation, which did "wisely provide [for the shipping of this nation], by ordering that no foreigner should bring any commoditie hither, but what was the growth of their own countrey; Whereby the *Hamburger* and *Flemming*, that run hackney all the world over, were a little stayed from coming hither crowding so thick." Some claimed that supporting the English carrying trade raised the cost of commodities for Englishmen. If "the same commoditie brought hither in any of our own vessels, cannot be afforded so cheap as what might be brought by others," countered Fortrey, "by reason indeed, that our shipping is much more chargeable, and better manned than any other; . . . this being rightly considered, it is rather an advantage than a prejudice to the publick; . . . and whatever it costs the dearer to the purchaser here, is no prejudice to the publick, when our nation receives the profit of it; especially it being by the increase of that, in which consists the greatest honour and safety of the kingdom [i.e., shipping]." Fortrey's argument for the regulation of trade ("concerning Merchants, associating themselves in companies") was structurally identical: "It is true," he wrote, that

> it is opposed by many, conceiving the free liberty of trade [, who say] if the trade were free, our own commodities having more chapmen, would sell at better rates, and what is brought home in return, would be distributed at much cheaper prices amongst the people. . . . In truth our commodities are sold the dearer to strangers [by companies, because they exercise a monopoly], and foreign commodities brought much cheaper; when both would happen contrary in a free trade, where each will undersell the other . . . ; and the prejudice that may happen by them to the workmen, or home chapmen, is

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> fully recompensed by the clear profit they return to the publick; of which they are members as well as others. (Fortrey 1907, 34, 36)

Tawney to the contrary, the new commercial mentality evidently implied not the emancipation of material self-interest from the tutelage of collective ethic and social consciousness, but the imposition on it of a new, but, from the economic point of view, much more productive, social harness.

Ironically, the argument that what served the interest of the individual did not always serve the national interest and that, in the case of a discrepancy, the latter was to be preferred to the former, could be used in defense of free trade. It was so employed, for instance, by Nicholas Barbon, a medic, businessman, and politician,[27] in the 1690 *Discourse of Trade*, which at least one student of economic thought saw as "the ablest refutation of the [mercantilist] theory of balance of trade previous to Hume and Adam Smith," an achievement that placed Barbon as an economist above Locke (Hollander 1905, 1). Barbon considered prohibitions and high interest to be the two chief impediments to the growth of commerce, and believed that while protective tariffs could advance some individuals' interests, in the long run they hurt the nation. "If the Suppressing or Prohibiting of some sorts of Goods," he wrote,

> should prove an Advantage to the *Trader*, and Increase the Consumption of the same sort of our Native Commodity: Yet it may prove a Loss to the Nation. For the Advantage to the Nation from *Trade*, is, from the Customs, and from those Goods that Imploys most Hands. So that, tho' the Prohibition may Increase, as the Consumption of the like sort of the Native; yet if it should Obstruct the Transporting of other Goods which were Exchanged for them, that Paid more Custom, Freight, or Imployed more Hands in making; the Nation will be a loser by the Prohibition. (Barbon 1905, 36)

By 1690, England had achieved that economic supremacy relative to its neighbors that was still only an aspiration for Fortrey in 1663. Gregory King opened his technical tract, *Of the Naval Trade of England [around] 1688 and the National Profit then arising thereby*, with the statement of "this great Fundamental Truth [:] That the Trade and Wealth of England did mightily advance between the years 1600 and 1688." London was already without doubt "the Largest, Richest, and Chiefest City in the World, for Trade" (King 1936, 61; Bar-

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bon 1905, 19). Barbon was aware of this and his *Discourse* reflected it. Confident of his nation's economic superiority and of its role in England's destiny, he was far less concerned to ward off dangers that might arise from foreigners' efforts to better themselves, than to elucidate the principles of economic growth that made England great. He wrote in the preface: "Notwithstanding the great Influence, that *Trade* now hath in the Support and Welfare of States and Kingdoms, yet there is nothing more unknown, or that Men differ more in their Sentiments, than about the True Causes that raise and promote Trade."

Barbon's position was that of a political economist, rather than of an economist proper, for he was mainly interested in "how [trade] may be most Profitable to the Nation." The extensive literature on the subject that already existed in his time, he thought, failed to address it adequately, because it was "byassed with Private Interest," even though, he noted parenthetically, all the authors *claimed* that their arguments, which ran "contrary to one another, as their Interest[s were] opposite . . . would be for the Advance of *Trade*, and Publick Good of the Nation." Still, he was far less suspicious of self-interest and perceived a far greater degree of natural correspondence between it and the general interest than Fortrey, at some points anticipating Smith's notion of the invisible hand. He also showed somewhat greater concern for the well-being of individuals, considering "the Benefits of Trade, as they Relate to Mankind"—such as "the Inhabitants in general [being] well Fed, Clothed and Lodged," alongside the benefits "that Relate to Government" (Barbon 1905, 5–6, 22–23).

Barbon's *Discourse of Trade* reached a degree of theoretical sophistication that makes it a landmark in the history of economic thought. However, it was very much a part of what was already a mighty current of English economic nationalism and in this respect does not stand out among other contributions. For the purpose of the present discussion, it might be worthwhile to mention just one other point Barbon makes, arguing, in effect, the inconsistency of the Protestant ethic and economic advancement. Barbon maintained that "prodigality is a Vice that is prejudicial to the Man, but not to *Trade*," while its opposite, that is, saving rather than spending money, which he called "covetousness," is "prejudicial both to Man and *Trade*;" so that "a Conspiracy of the Rich Men [not to] spend, would be as dangerous to a Trading State, as a Forreign War; for . . .

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they would make the Nation poor, and the Government great Losers in the Customs and Excises that ariseth from Expense." For this reason, he advocated conspicuous consumption and believed that fashion was "a great Promoter of *Trade*, because it occasion[ed] the Expence of Cloaths, before the Old ones are worn out: It is the Spirit and Life of *Trade*." Since fashion kept "the great Body of *Trade* [i. e. the economy] in Motion," it was most unreasonable to exclaim against its vanity; instead, Barbon advised that "the Promoting of New Fashions, ought to be encouraged, because it provides a Livelihood for a great Part of Mankind." Not everyone was of this opinion, however, and Barbon took to task Thomas Munn in particular for commending "Parsimony, Frugality, and Sumptuary Laws as the means to make a Nation rich" (Barbon 1905, 32, 33, 11). Thus it would be fair to point out that some of Barbon's contemporaries, apparently, did agree with Weber's notion of the character congenial to the development of the modern economy and might have practiced, as well as preached, this-worldly asceticism.

Anticipations of Adam Smith

No account of English economic nationalism prior to the Industrial Revolution is complete without a discussion of the place in it of Daniel Defoe. One of the greatest writers of the period, and perhaps the most popular, Defoe was an economic nationalist *par excellence*, in whose numerous writings on commerce the various elements of this vigorous trend of thought received their fullest expression and acquired additional power to influence, excite, and spur on people already tense with collective economic ambition and set on a course of constant "improvement." He was also a preeminent example of the effortless, straightforward transformation of English into British nationalism, and, though this expansion of identity (which for some involved its modification) was certainly more problematic for many of his contemporaries, for this reason he represents a very important case for any analysis of late-seventeenth and early-eighteenth-century English and British nationalism.

From 1704 to 1713, Defoe published the *Review*, "admittedly the most significant periodical of his time" (Moore 1934, 4), the first "journal of opinion, . . . which taught the masses in Queen Anne's reign what to think upon important political and social questions"

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(Secord 1938, xv). It was originally conceived of as a commentary on the war with France in which England at the time was engaged, but its scope grew broader, as reflected in the title of the third volume: *A Review of the State of the English Nation*. In Volume IV, no. 12, the title was modified again to *A Review of the State of the British Nation*. In his writings on commerce, among others, after the Union (which Defoe, in a small way, helped to bring about with his public addresses in Scotland as well as in England),[28] he used the terms "English" and "British" interchangeably and often employed them explicitly as synonyms, referring to the "English, or British" nation, interests, trade, etc. The ease with which Defoe himself metamorphosed from an Englisman into a Briton was consistent with his portrayal of the model "true-born Englishman" as an immigrant, and might have to do with the fact that he was himself, to begin with, an Englishman of foreign extraction and rather recent immigrant stock.

For Defoe, there was no longer any doubt that the economic dimension had become fundamental in social life, and that political power and national prestige had come to rest on it. He was aware that this was a recent change. He put this thought forward on many occasions, on at least one of them introducing the now-famous phrase with which we associate the birth of modern economics. "The Power of Nations," he wrote in vol. II, no. 20 of the *Review*, "is not now measur'd, as it has been, by Prowess, Gallantry, and Conduct. 'Tis the Wealth of Nations that makes them Great." He was also aware that something had changed in the very nature of the economic process, and that the evident and indisputable economic preeminence of England (or Great Britain) owed to the fact that English trade (still the conventional term for "the economy") epitomized this change. He saw England, in distinction to other countries, as essentially "an improving nation," "improvement" being a contemporary equivalent of "progress." Its economy, already "an immense and almost incredible Thing" (Defoe 1927, 81), exhibited an unusual inherent capacity for growth. This capacity, Defoe knew, did not exist before. Introducing the subject "Of the first Rise, Growth and Encrease of the *Commerce* of *England*" in *A Plan* [an overview] *of the English Commerce*, Defoe stressed the historical recency of this change and resorted to a set of very suggestive metaphors to elucidate its nature:

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> It is something difficult to adjust the Terms of our first Part of this Work . . . *viz.* the Rise, Growth, and Encrease of our Trade, all which Words, as they imply a Progression, they necessarily imply a stated Period, like an Epocha of Time, from whence the Motion might be said to begin like the starting Post, or Place of a Race, where all that run, set out exactly upon an Equality, whatever Advantage is obtain'd afterwards, being the Effect of the Strength and Vigour of the Racers. . . .
>
> I suppose all Nations had some Trade, and all People some Dealing with one another from the Beginning. [But to focus on that] would lead us back into dull Speculations of the Nature and Original of Commerce; a dry useless Subject, and therefore carefully avoided in my Title, where it may be observ'd, that I do not call this Work a History of Trade, or a History of the *English* Trade; but a History of the *Rise, Growth*, and *Increase* of it [i.e. of economic growth or of the modern economy only]; by which I mean as above, from the Time . . . when standing upon the Square with the rest of the World, *England* gave it self a Loose, and got the Start of all the Nations about her in Trade; and having held it ever since, her Commerce is by that Means arriv'd to that Prodigy for Magnitude, which it appears in at this Time, and in which 'tis acknowledg'd by all her Neighbours, she out-does all the Nations in the World. (Defoe 1927, 81–82)

The clarity of Defoe's vision—of nations racing against each other for economic supremacy, that is, of international competition as the framework of the economic process; of the exceptional nature of this process in economic history; and, finally, of England's "takeoff"—is astonishing. He shows himself far more historically conscious than many of today's economic historians and more perceptive of the springs of economic development than many a later theorist. Nevertheless, trade remained for him a "half-known thing" and all his life, alongside his many other projects, he strove to penetrate its "hidden Mystery," the "Dark Gulph of General Negoce." He thought that in England, in particular, no effort was too great to achieve such understanding and lamented his countrymen's ignorance in the area of paramount national importance: "In a Nation rais'd as we are by Trade, fam'd for carrying on the most extended Commerce in the World, and particularly prosperous in the greatest Undertakings, whether for Improvement at Home or Adventure Abroad, nothing is more wonderful, than to see how ignorant the Generality of our People are about it" (Defoe 1927, vii).

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His *Complete English Tradesman* was written with a view of contributing to the correction of this deficiency and the explicit purpose of describing the "*English* or *British* product" and "lay[ing] down general maxims" of proper economic behavior for the benefit of the businessman.

Among the principles of business ethics Defoe advocated was patriotism in commercial transactions, specifically a preference for native commodities over foreign importations. An admonition on the subject was very much in order, since it was "so much the humour of the people of this nation (more perhaps than of any other in the world) to despise the growth or product of their own country and give the most extravagant prices for foreign manufactures, whether better in kind or not" (Defoe 1989, 143). As an example, Defoe described a typical scene in a silk-merchant's shop, which stocks the excellent creations of English artisans, bought very cheaply, but, in light of the taste of English customers for all things French, sells these English silks as French imports for an exhorbitant price. "The first question the ladies ask is, If they are really *French*? The mercer makes no scruple to affirm they are, and that perhaps very solemnly; but fails not to add another black article, '*French!* yes, madam, your Ladyship may depend on it, *they are* French; *we can make no such things as these in England.*'" "There are two direct falsehoods by way of preliminary," fumes Defoe, "besides laying a scandal upon his country, as if we were not able to come up to the *French*, or any other nation, in the perfection of the manufacture; whereas this known we now go beyond them in every branch of the trade, and in every particular article of the performance" (Defoe 1989, 144–45). Besides being ethically objectionable, the merchant's behavior is most impolitic, giving a bad name to business and thus, in the end, turning against the unethical merchant himself.

> Here is general trade propagated by a double crime; the *first*, against *man*, in the foolish depressing a useful home manufacture, discouraging trade, depriving the poor of our own country, and affecting the labours of foreigners; and the *second* against *truth*, and the Author of truth, in pushing on business at the expense of our morals. . . . Who would be a rich man at this price? and how do these things give life to the general scandal upon business, *That a tradesman cannot be an honest man*. . . . Indeed, in such cases, this little better than the devil driving the trade, and the tradesmen being the *devil's* journey-

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> men. . . . Thus the *tradesmen* get the *money*, and the *devil* gets the *tradesmen*.

Honesty, advises Defoe, which equals patriotism, is the best policy. It has the triple advantage of underselling the French (without in the least hurting the material interest of the merchant), preserving the reputation of businessmen, and advancing the productive capacity of the country. "Would the mercers act the honest part of their country," he urges,

> and to the manufacture wrought at home, as they really ought to do, and propagate our own manufactures with their utmost endeavour, refusing universally to sell any *French* or foreign silks, which really and *bona fide* there is no manner of need of; and would they, at the same time; tell the ladies plainly, that *France* cannot furnish any thing finer, richer, more beautiful, or more agreeable than is made by our own weavers, and that all these charming patterns, fine colours, rich brocades, etc. are made at home, and are inimitable from abroad, as is most true: Would they do thus, . . . they would soon effectually suppress the foolish humour of despising our own manufacture, which is so general among the people, and our own weavers would soon advance their improvements to such a degree, as to send their wrought silks abroad, even to *France* itself.

As ethical imperatives conspire with common sense to bring the desired result, Defoe leaves the subject "upon the minds of the buyers and sellers too, to regulate their conduct by it for the future, as the profit of the one, and the conscience of the other, and the honour of the kingdom to them both, may induce them" (Defoe 1989, 146–47). Defoe's trust in the "invisible hand" may not be blind, but he trusts it nevertheless.

Several chapters in the manual are intended to teach businessmen proper self-respect. Such self-respect is justified by the centrality of commerce among the factors that make England great, and by the position of the commercial classes in the social stratification of the English nation, which Defoe sees as a prominent national trait. With the help of extracts from the genealogies of "illustrious Families of our *English* Nobility" Defoe proves the literal nobility of tradesmen in England, showing "abundantly . . . the near Relation . . . between many of our principal Nobility, and the eminent Traders of *England*," not the least of his design being with such

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proof "to inspire citizens on one part, with a noble emulation, and a resolution to do nothing unworthy of themselves; and the Nobility on the other, with a desire of cherishing and protecting . . . the trade and commerce of this nation, to which they are so much indebted for their high distinctions in life" (Defoe 1989, 173). He then devotes to the subject a further chapter, entitled "Of the Dignity of *Trade* in *England* more than in other Countries" (Defoe 1989, Ch. XXV, all quotations below from pp. 174–82). "Besides the benefit which we reap by being a trading nation," he writes, "which is our *principle glory*, trade is a very different thing in *England*, than it is in many other countries, and is carried on by persons who, both in their education and descent, are far from being the dregs of the people." On the contrary. King Charles II "used to say, *That the Tradesmen were the only Gentry* in England: His Majesty spoke merrily, but it had a happy signification in it." The memory of the King's half-joking recognition leads Defoe to a somewhat irrelevant panegyric to the nation at large, which deserves to be quoted in full for its charm if nothing else.

"I make no scruple to advance these three points in honour of our country," he says, "*viz.*,"

> 1. That we are the greatest trading country in the world, because we have the greatest exportation of the growth and product of our land, and of the manufacture and labour of our people; and the greatest importation and consumption of the growth, product, and manufacture of other countries from abroad, of any nation in the world.
> 2. That our climate is the best and most agreeable to live in; because a man can be more out of doors in *England* than in other countries.
> 3. That our men are the *stoutest* and *best*; because, strip them naked from the waist upwards, and give them no weapons at all but their hands and heels, and turn them into a room, or stage, and lock them in with the like number of men of any nation, man for man, and they shall beat the best men you shall find in the world.

As in England businessmen are not, "as it generally is in other countries," of the meanest sort of people, neither "is trade itself in *England*, as it generally is in other countries, the meanest thing the men can turn their hand to." Rather, it is a magnet for talent, "being the readiest way for men to raise their fortunes and families; and therefore . . . a field for men of figure and of good families to enter upon." In thus stressing what "value we put upon Trade and

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Tradesmen in *England*," Defoe believes he is doing "a particular piece of justice to ourselves," i. e. the nation. Indeed, England being defined as "a trading nation" and its "whole glory and greatness . . . being . . . raised by Trade, . . . which is the only fountain from whence we all, *take us as a nation*, are raised, and by which we are inriched and maintained," respect for trade is an expression of pure patriotism; to show it is to uphold national dignity and self-respect.

Trade inspired patriotism and boosted England's self-respect in other ways as well. It increased the power and greatness "of the British nation" through navigation and discoveries, populating colonies "as well in the islands as on the continent of America . . . entirely [with the people] from *Great Britain* and *Ireland*," rendering obsolete such traditional means of empire-building as war and the subjugation of foreign peoples (this was a common idea, developed, among others, by Barbon). And, unless they removed to the said colonies, it increased the attachment of British citizens to their native island, "where they are multiplied to that prodigious degree, and do still continue to multiply in such a manner, that, if it goes on so, time may come that all the lands in *England* will do little more than serve for gardens for them, and to feed their cows, and their corn and cattle be supplied from *Scotland* and *Ireland*." Conspicuously few English, claimed Defoe, relative to other nations, emigrated and sought service in other countries, the reason for which, he thought, was nothing "but Trade, the increase of business at home, and the employment of the poor in the business and manufactures of this kingdom, by which poor get so good wages, and live so well."

The prosperity of the people, of the trading and laboring classes, had itself become a distinctive national trait, and the point was so remarkable and so worthy of every recognition that, in Defoe's opinion, no amount of repeating would make it trite. He therefore belabored it endlessly, writing in *The Complete English Tradesman,* among other places, that "the same trade that keeps our people at home, is the cause of the well-living of the people here; for as frugality is not the national virtue of *England*"—another missile in the direction of the Protestant ethic argument—"so the people that get much, spend much; and as they work hard, so they live well, eat and drink well, cloath warm, and lodge soft: in a word, the working manufacturing people of *England* eat the fat, drink the sweet, live better, and fare better than the working poor of any other nation in

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Europe; they make better wages of their work, and spend more of the money upon their backs and bellies, than in any other country." This general prosperity, created by economic growth, in its turn contributed to the expansion of the home market, greatly increasing overall demand and allowing, in particular, "the expense of the poor," i. e., the working classes, which caused "a prodigious consumption both of the provisions, and of the manufactures of our country at home," and thus stimulated further economic growth.

The definition of prosperity as a national characteristic and an object of national, patriotic pride marked an important stage in the understanding of the nature and significance of the economic power or "the wealth of nations." Defoe's interpretation of it was far more democratic than that of his predecessors among English economic nationalists as late as Barbon, and fully anticipated Adam Smith's individualistic conception. "The wealth of the nation," thought Defoe, "undoubtedly lies chiefly among the trading part of the people," which was the richest class. This meant that the wealth of a nation, in general, was the wealth of the members of the nation, a sum or aggregate of their individual fortunes, rather than being equated with the economic resources of the state. Or, rather, the power of the state to command economic resources and harness the wealth of the nation to political and military goals was a function of the wealth of the masses of the nation's members (and their willingness to part with some of it). To those who might doubt that this was in fact so, and that the economy, in consequence, was indeed the foundation of the nation's power, glory, and greatness, Defoe retorted:

> And by whom have the prodigious taxes been paid, the loans supplied, and money advanced upon all occasions? By whom are the banks and companies carried on? and on whom are the taxes and excises levied? Have not the trade and tradesmen borne the burden of the war? And do they not still pay four millions a year interest for the public debts? On whom are the funds levied, and by whom the public credit supported? Is not Trade the inexhausted fund of all funds, and upon which all the rest depend?

This was not an apology, but a frank and confident glorification. Defoe added his clear and exuberant voice to the hymn of praise that his compatriots had been intoning since the sixteenth century, and which was to burst into a mighty hallelujah in the "noisy cult

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of commerce"[29] of his own age. This cult, whose supreme deity was the nation and whose credo held that economic interest equaled the national interest, inspired its enthusiasts to incessant activity, which made them rich and gave them "the magnificent energy to change in a century the face of material civilization."

I said before that nationalism was the source of the spirit of capitalism. I would like to rephrase this now: the spirit of capitalism was nationalism. Nationalism was the ethical motive force behind the modern economy of growth. The economic process was reoriented very soon after the emergence of national consciousness, and if the modern economy was not as robust at birth as it was to become some time later, neither, one should remember, are babies, which is no reason to confuse a birthdate with a moment of maturity. To what extent nationalism contributed to the industrial transformation of the modern economy and was the motivational lever of the Industrial Revolution is a separate question that cannot be probed in this essay. The important point is that when the Industrial Revolution began, the British economy was already capable of, and consciously oriented to, sustained growth.

NOTES

1. I have articulated the reasons for my disagreement in a recent essay, "Nationalism in Eastern and Western Europe Compared," in Hanson and Spohn 1995.
2. They write: "Rather than remain fixed on the divide between ethnic and civic nationalism, a trope that has dominated much of the scholarly discussion since Hans Kohn, we urge the consideration of a distinction within the broad category of civic nationalism itself. That is to say, the collectivist form of civic nationalism, far from being a mere theoretical possibility to be easily dismissed, has historically been the competing democratic alternative to Anglo-American liberalism" (Breckman and Trägårdh 1996, 405).
3. For example, in response to my depiction of the anti-Western Romantic nationalism in Marx's early essays, they exclaim: "*Who can read* 'The German Ideology' or 'The Communist Manifesto' *without being struck by Marx's awe* before the global process of transformation propelled by the Western bourgeoisie? *Moreover, who can miss* his belief that the expansion of the bourgeois form of production necessarily meant the universalization of the working class that Marx believed would be the agent of the coming social revolution?" (Breckman and Trägårdh 1996 393–94; emphasis mine throughout). This despite my explicit statement in "The Worth of Na-

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tions" to the effect that, given the nature of Marx's theory, he cannot be considered an enemy of capitalism.

4. If Breckman's and Trägårdh's idea is that globalization in the nineteenth century (or before) was the reason for the emergence of nationalism and continues to sustain it today, then the contradiction is in the claim that globalization at the same time diminishes the possibilities of national sovereignty and democracy. They cannot claim both "more globalization—more nationalism" and "more globalization—less nationalism."
5. The terms are, respectively, those of Rostow and Mantoux.
6. The full phrase Rostow used when he first introduced his concept, quoted in Flinn 1967, 8.
7. The word "revolution" here denotes a dramatic and thoroughgoing change which gave rise to a novel economic system.
8. In Mathias 1979, see especially ch. 1, "British Industrialization: Unique or Not?" and ch. 3, "Who Unbound Prometheus? Science and Technical Change, 1600–1800."
9. The list of participants in the controversy around Rostow's *Stages of Growth* (on which see, for instance, Rosovsky 1965) is one indication of the importance of his work; the publication of the book in a third and expanded edition in 1990, thirty years after its original appearance, is another.
10. Hamilton, in one of the latest installments in the debate, provides a long list of works in economic history that do not make any reference to the Weber thesis or mention it only in passing, seeing this neglect as an implicit refutation (Hamilton 1995, 9–10 n10).
11. Which is the view Breckman and Trägårdh attribute to me (1996, 398).
12. I have discussed the role of English nationalism in the rise of modern science in Greenfeld 1987.
13. Which is another point Breckman and Trägårdh find problematic (400).
14. See the discussion of Defoe below.
15. Weber would refer to it as a form of rationalization, and I believe indeed that it was nationalism that lay at the root of that "peculiarly Occidental rationalism" that he tried to understand.
16. Thomas Milles's 1604 "Customer's Reply [to Wheeler]," quoted in Hotchkiss 1931, 82.
17. This is a line from a poem (probably by William Glanvill) about Gresham College, which introduced Gresham thus:

    If to be rich and to be learn'd
    Be every nation's cheifest glory
    How much are English men concern'd,
    Gresham, to celebrate thy story
    Who built th'Exchange t'enrich the Citty
    And a College founded for the witty.

18. Gresham's letter to the Queen, quoted in Hotchkiss 1931, 41.

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19. "Dutch" (in singular and in plural, "Dutches") was used as a synonym of "German" at the time. "Hollander" was the proper term for Dutch.
20. All the quotations here and below are from the edited text.
21. Hotchkiss's and early seventeenth-century characterizations.
22. Hotchkiss's phrase.
23. Supple 1964 contains an extensive list of contemporary publications on business matters.
24. The argument of Thomas Mun's "England's Treasure by Forraign Trade, or the Ballance of our Forraign Trade is The Rule of our Treasure," published in 1664 after Mun's death by his son, John Mun (who drew attention to his father's patriotism in the dedication), first appeared in print in 1621 as "A Discourse of Trade from England."
25. Brenner 1993 by and large focused on matters other than the national sentiment of seventeenth-century businessmen, characterizing Mun, for instance, as "the great theorist and propagandist of English national power through English commercial power" (Brenner 1993, 272).
26. This seems to be an early version of the principle of "expropriation of expropriators."
27. A fellow of the College of Physicians, he founded the first insurance firm in London after the fire of 1666, as well as a land bank in the 1690s, and was twice elected a member of Parliament.
28. He was, in fact, assigned by Robert Harley to work for the Union, and wrote some forty poems and pamphlets, in addition to numerous articles in the *Review, History of the Union,* and *Memoirs of the Church of Scotland,* which may be considered as propaganda for it, including a series of essays entitled "Removing National Prejudices." See Backscheider 1986, 55-58.
29. The phrase is Linda Colley's (1992, 61). Colley's quotations suggest that while, in the period on which she focuses, the arguments remained essentially what they had become towards the end of the seventeenth century, their prose had improved, acquiring the smoothness which comes from use.

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